EXCHANGE AND TRADE CONTROL

EXCHANGE AND TRADE CONTROL IN THEORY AND PRACTICE

BY

H. E. EVITT

FELLOW OF THE INSTITUTE OF BANKERS (BECKETT PRIZEMAN, TRIPLE HONOURS); LECTURER IN FOREIGN BANKING AND EXCHANGE TO LOCAL CENTRES OF THE INSTITUTE OF BANKERS, THE CITY OF LONDON COLLEGE, ETC.; CORPORATE MEMBER OF THE INSTITUTE OF EXPORT; AUTHOR OF "A MANUAL OF FOREIGN EXCHANGE," "AN INTRODUCTION TO THE PRACTICE OF FOREIGN EXCHANGE," "PRACTICAL BANKING," ETC.

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PREFACE TO SECOND EDITION

By the time the revised version of this book is published, over four years will have elapsed since the cessation of active hostilities. The first high hopes of speedy economic recovery, the restoration of international trade, and a return to something approaching pre-war normalcy have faded, and the greater part of the world in general and this country in particular is still struggling against adversity under conditions of severe austerity.

History, however, must needs be recorded, and the epic nature of the post-war struggle and the revolutionary change of international thought and action are certainly well worth recording. It is quite certain that we are witnessing a transition from the old to a new world order of one kind or another, and the steps which have been and are being taken to this end and their implications and eventual corollaries are of the first importance to all those with any interests in international commerce and finance. Necessarily, even this revised version is incomplete, and gives the progress of events to date in outline rather than in detail, but it is hoped that it will at least provide a background against which further developments can be studied and analysed.

I am indebted to my Co-Directors on the Board of Godsell & Co. Ltd., 1-2, Gt. Winchester Street, London, E.C.2, for their permission to reproduce as appendices to this book several documents which were prepared specially as supplements to the monthly Information Sheet which this Company issues to its Clients. The Glossary of E.R.P. terms was originally compiled by and appeared in the *Financial Times*, to whom I make my sincere acknowledgments.

H. E. E.

LEIGH-ON-SEA, ESSEX.
January, 1949.

PREFACE TO FIRST EDITION

THIS little book is intended to act as a guide to and summary of current history following the author's *A Manual of Foreign Exchange*.

It is an attempt to present in ordinary language what would appear to be the basic principles underlying any system of control of a nation's external finances and, since it deals with principles, it neither examines nor explains at any length what are probably ephemeral details of the mechanism of control, even as it at present exists in this country. The world to-day abounds in experts who can tell one how to fill up a form !

Also, as all types of planned economy are hardly out of the experimental stage, the book does not pretend to analyse exhaustively any past or present system of exchange or trade control. It tries to link up the main factors involved in any such system because the control of actual purchases and sales of foreign exchange is but one digit on a many-fingered hand—a hand which may wear a velvet glove (as in this country) or which may pack a heavy punch !

If the book assists the bank man, the trader and the student to clarify his ideas on this very complex and in many ways highly technical subject, it will have served its purpose.

As a recent report of a technical sub-committee of a political party comments, several types of control will not and should not vanish immediately the guns cease fire ; if they did, chaotic conditions would soon supervene. But, the report adds, " As soon as these conditions disappear the case for government controls dwindles. They have no intrinsic value in themselves. They are liable to lead to hold-ups and they slow down the speed of industry to adapt itself to consumers' needs."

I offer my grateful acknowledgments to the very busy banker who spurred, caustically criticized and genially advised me on the writing of this digest. H. E. E.

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CHAPTER I

Introductory—Meaning of exchange control—What the exchanges are, what they do and some of the factors by which they are affected—Control by economic forces—Control by gold—" Planned " control—Factors affecting " planned " control.

WHEN penning these lines we were fighting for our lives, fighting that we and those who come after should not be merely slaves to a would-be " master-race," fighting, as we say, for Freedom. But in a civilized or even a semi-barbaric society " freedom " does not mean unrestricted licence for each individual to do exactly as he or she pleases. Untrammelled liberty for all would mean a reversion to the jungle law of " the weakest to the wall." Consequently, certain restraints are imposed (whether by " taboo " or by legal enactment depends upon the state of advancement of the society), designed to secure such amenities as the safety of life and property, the prevention of the exploitation of labour, *e.g.*, slave or child labour, the suppression of drug and white-slave traffic and latterly, in the more advanced communities, such a distribution of wealth and opportunity as will, without destroying the incentive to individual enterprise, give each member at least the means of subsistence during both his working life and his declining years.

Such measures are " controls " in that they attempt consciously to plan the life of the community for the benefit of the majority even though personal liberty is interfered with to some extent in the process. A line must, however, always be drawn between " licence " and " liberty " and it is certain that our national character would not submit tamely in ordinary circumstances to the regimentation imposed on and accepted by other countries. While, therefore, modern social life demands certain controls which impose restraints

on individual liberty for the benefit of the community as a whole, it does not follow that each and every such restraint is a good thing in itself, and a "mean" must be sought between the granting of undue licence to the bad citizen, the avaricious or the over-zealous and the imposition of undue control over the economic freedom of the individual. The demands of total war result in lives and liberties being controlled to the *nth* degree and the post-war removal of what can be proved to be unnecessary (or no longer necessary) constraints is bound to be a lengthy and laborious process. The gradual freeing of the domestic life of the nation is, however, bound up with the extent to which its external life can be freed and in this we have not the only voice. If world chaos is to be avoided in the process of rehabilitation, an almost world-wide scheme of rationing will have to be introduced during the transition period both for raw materials and for finished products ; a wild scramble for primary products must ensue without wise planning and organization. Further, since *homo sapiens* demands payment for his product or his labour, either we must revert to the cumbersome, time-wasting system of barter or we must also plan and organize our means of payment. Since every seller deprived of a market is a buyer robbed of his purchasing power, this requires that we must be allowed to export those of our products which the world most needs in order that we may purchase, in our turn, the things we most need. Unless this is planned our densely populated country with its highly industrialized social system cannot hope to import the cotton, copper, manganese, mica, rubber, etc., without which we should be unable to compete in the world's markets. Such planning can, however, be carried out largely within industry itself provided that wise and farsighted government backing is forthcoming. These are such obvious truths as to look almost fatuous when written but, since they are truths, they must be recognized as practical problems and the possible methods of their solution examined so that the balance between the self-interest of the individual and the

common weal may be preserved. And is not the common weal now international and not merely national?

Before commencing an examination of the elements of exchange control we must first define what it is that we are to examine. Exchange control is by no means solely concerned with the control of international movements of money across what are technically called "the exchanges." Money of itself is useless—you cannot eat it, wear it, or live in it—and its only function is to act as a denominator of value, whether as a medium by which one can exchange the reward of one's labour immediately for the product of the labour of others or as stored-up purchasing power resulting from saving rather than immediate spending.

But it is evident that money itself needs some control if it is properly to perform its function and any distrust of the permanence of a country's money as a standard of value or purchasing agent quickly displays itself by a general rise in prices of goods and labour—in other words, the money becomes less valuable. A primary function of government, therefore, is to take all possible measures to ensure a stable level of prices, *i.e.* an absence of fluctuation in the general purchasing power of money.

The use by different countries of differing units of money also creates a difficulty. A resident in one country may own the right to some of the currency of another country, but he can only have useful possession of the currency in one of the places where it passes current and his desire to own such currency will depend upon its utility to him for either present or future spending. If, for example, you were to sell a picture in Sweden and received Swedish kroner notes in payment, you would hardly think of tendering them to your local butcher in exchange for your week's meat ration; such notes pass current mainly in Sweden. You would probably have asked your buyer to pay you in sterling, but he has only his own currency and pound notes do not pass current in Sweden. How, then, does the buyer pay and the seller receive? By means of the foreign exchange markets of the world in which

for many years (there are even records of dealings in one kind of money for another in Babylonian times), expert dealers are prepared to buy or sell, at a price, any recognized national currency. To them, such currencies are no more than commodities and their prices are based on current demand and supply and on the popular estimate of the present and probable future general internal purchasing power of the currency in which they are dealing. Since such dealings involve the exchange of one currency for another they are known as dealings in " foreign exchange " and the obvious people to conduct them are the bankers. Space does not permit a dissertation on exchange dealings in general and anyone interested can read *A Manual of Foreign Exchange.* We are only concerned here with measures of control.

What determines whether one pound shall be worth four or five dollars or fifteen or twenty Swiss francs ? It depends firstly on the willingness of a seller to sell and of a buyer to buy at a given price. If an American finds he can sell a motor-car in this country for £100 and the cost of the car plus shipping charges and his profit comes to $400, he will trade as long as he can get at least $4 for each £1. His ability to get this price from an exchange dealer depends on whether the dealer in turn can find someone with dollars but who wants pounds and who is prepared to sell his dollars at a rate of rather more than $4 to the pound. A greengrocer used to sell a fruit called a banana at, say, five for sixpence. He was able to do so because he could buy from a wholesaler at, say, seven for sixpence, *i.e.* he gave and received sixpence and showed his profit for the time being in bananas until he disposed of his surplus for more sixpences. This illustrates exchange dealing at its simplest, and the analogy must not be carried further back as currency does not grow on currant bushes ! The exchange dealer therefore has to know where and at what price (the rate of exchange) he can sell such foreign currency as he buys or buy back what he sells. Our American who wants dollars in exchange for his sterling may, for instance, have bought rubber in the Dutch Indies. The

rubber grower may have bought the timber for making cases from Sweden where in turn someone may have bought woollen piece goods from Yorkshire. The exchange dealers of the world then proceed to equate these multilateral transactions by taking dollars from the Dutchman and providing him with Swedish kroner which they get by taking sterling from the American (who eventually gets the Dutchman's dollars) and passing it over to the Swede !

As long as a currency has a certain internal purchasing power it will always command a proportionate rate of exchange against other currencies. For example, if both Poland and Germany were producing in 1937 a certain type of coal, an Italian buyer of coal would purchase it in whichever of the two countries showed him the better bargain by a combination of the exchange rate with the internal price of coal. Thus if the Polish-Italian exchange rate was 100 zloty to 100 lire and a ton of coal cost 50 zloty in Poland, an Italian could buy 2 tons of coal for 100 lire ; but if the German-Italian exchange rate were 25 marks to 100 lire and coal in Germany were 10 marks per ton, he could buy 2½ tons with his 100 lire. There would then be a fourfold effect :—

(*a*) The diversion of the Italian demand for coal from Poland to Germany would leave Polish producers with an evergrowing surplus which would induce them to offer supplies at a lower price in the hope of attracting buyers ;

(*b*) at the same time the falling-off in the demand for zloty against lire would force owners of zloty who wanted lire to offer a higher rate of exchange in the hope of attracting buyers, *i.e.* the zloty cheapens ;

(*c*) the increase in the demand for German coal would reduce stocks there and lead producers to ask a higher price for further deliveries ;

(*d*) the increase in demand for marks against lire would force those who had lire and wanted marks to offer a better rate of exchange in the hope of attracting sellers of marks, *i.e.* the mark becomes dearer.

The sum total of all these influences is that internal prices-

cum-exchange rates adjust themselves until the price of either Polish or German coal to an Italian is roughly the same, *e.g.*, if in Poland the exchange rate rises to 108 zloty per 100 lire and the price of coal falls to 48 zloty per ton while in Germany the mark becomes dearer until only 24 can be purchased for 100 lire and coal rises to $10\frac{3}{4}$ marks per ton, then an expenditure of 100 lire would give an Italian roughly $2\frac{1}{4}$ tons of coal from either country. Neither exchange rate would, however, move beyond a point at which it became much dearer or much cheaper to buy any article in common demand in one or the other country because the process of equating prices and exchange rates would begin afresh.

This example is, of course, impossibly simple, as a diversion of trade in one article or commodity from one country to another is probably followed at once by an increase or decrease, respectively, in trade in something else so that this "natural" control only comes into play when there is a general fall in the price level of any country selling competitive goods. On the other hand, a general rise in a country's price level may not cause an immediate rush of competitive goods from elsewhere for sale at the higher prices as it may well be that the fall there in the purchasing power of money is due to well-founded distrust of the currency itself, *e.g.*, marked inflation or debasement. Such a "natural" control (which, incidentally, was the only control operative over a period of many years in countries having only an inconvertible paper currency and a tendency towards revolutions), postulates, however, movements of some violence in exchange rates and internal prices *before* the "natural" corrective comes into play and only when considerable economic damage has been done. This it is the business of government to avoid. A stable internal price level tends to a stable exchange rate for the home currency in terms of other stable currencies and vice-versa ; the government must, therefore, concern itself with the preservation of stable external exchange rates as well as with stability of internal prices and the purchasing power of the currency.

The provision of these desiderata has occupied responsible minds for many years and the growing appreciation of the importance of such conditions was evidenced by the widespread adoption of some form of " gold-standard " in the years prior to 1914 and from 1925 to 1931. A " gold-standard " relates the local unit of money to a given quantity of gold so that between any number of countries adhering to a similar system the currency of any one can be said to have an exchange value in terms of each of the others which can only vary to the extent of the cost actually of moving gold from one centre to provide local currency in another. For the various forms of " gold-standard " and their technical working and effects the reader is referred to *A Manual of Foreign Exchange* and it is sufficient to point out here that a " gold-standard " gives a stable exchange rate between the countries adopting it but ties the purchasing power of each currency to one commodity only, viz., gold. While highly intelligent efforts were made by the governments using the standard to couple it with internal management or control of currency and credit and thus attain both a stable exchange and a stable internal price level they have not yet succeeded in *anticipating the effects of economic factors, e.g.*, good or bad harvests, droughts, discovery of new processes, etc. These, working through the normal commercial system, automatically cause a disturbance in credit conditions and so force an influx or efflux of capital in the form of gold. For instance, to take again the Italian-Polish-German coal example given earlier, were each of the three currencies concerned to be based on a gold standard the following adjustments would take place :—

(*a*) The reduction in demand for zloty against lire would cause the former currency to depreciate in exchange value to the point where a holder of zloty who was in need of lire would arrange for an exchange dealer to effect a gold transfer by buying the right to gold with zloty and re-selling it for lire. This is equivalent to an export of capital which reduces the credit base, makes for monetary stringency, higher interest rates and lower internal prices. If the mark-lire exchange

warranted it, gold rights might be purchased for zloty and sold for marks and the marks then used to buy lire.

(*b*) The demand for marks against lire would cause the value of the former to rise until a holder of lire who wanted marks would arrange for the purchase of gold rights against lire and their sale against marks. Italy would thus have gold coming in and going out so that her credit structure would be comparatively unaffected but Germany would be receiving an influx of capital. This would have the effect of broadening the credit base and creating monetary ease which should lead to a rise in internal prices.

The eventual equilibrium in external prices would, therefore, be attained by a relatively small movement in the exchange values of the zloty and the mark and a pronounced fall in the price of coal in Poland accompanied by a corresponding rise in Germany.

Whether or not a currency has any intrinsically valuable internal backing such as gold, its *external gold value* is inextricably locked with its *internal price level*, and any marked change in the one must perforce affect the other. While dealings in currencies as if they were commodities were permitted all over the world, speculation in the exchanges was rife and private speculators could go a " bull " or a " bear " of French francs, sterling, Dutch florins, Spanish pesetas, etc., just as easily as they could in the shares of a group of wild-cat gold-mining companies. Fluctuations of 10 per cent. in the external value of a currency have taken place in the course of a few days or even hours, with a consequent disturbance of both the import and export trade of the country concerned since traders could not adjust the prices of their goods in step with the rapid movements in the exchange rate. Moreover, in such conditions even a gold standard currency suffers, in that quick and violent movements in its external value mean a succession of gold imports or exports causing repeated fluctuations in the basis of the credit structure with automatic repercussions on the rate of interest and the price level. Certainly *ex post facto* steps can be taken officially by the

authorities to iron out or at least to minimize the internal effects of the ebb and flow of gold but this has raised the modern problem of whether it would not be better to plan consciously for stability of prices, monetary purchasing power and exchange rates and to control the normal effects of economic or political causes by *anticipatory* action.

This planned control and its theory and practice have certainly made great strides over the past decade. It is based primarily on the need to make money more the servant and not the master of trade, since it is by external and internal trade that the wants of man are met, and on the axiom that any country must take steps to see that, over a period, debts due by it to other countries are balanced within a little by debts due to it by those other countries as a group ; otherwise exports of capital will have to be made which by impoverishing the exporting country will impose a lower standard of living on the population in the shape of lower incomes and longer hours until the excess of production over consumption has renewed the capital reserves.

Some form of " control " over the internal and external value of money is obviously necessary to provide a sure foundation for commercial enterprise ; modern conditions have shown that an " automatic " control—such as that provided by a full gold standard—needs to be both reinforced and given an essential elasticity by " planned " control. Traders and manufacturers must be placed in a position to lay " long-term " plans which they cannot do in conditions of price fluctuations caused by variations in the internal and/or external purchasing power of their money of account. All schemes for social betterment ultimately depend upon the community's ability to provide funds, either by taxation or by direct contribution, and the national income out of which such payments must be made depends upon the level of trade and employment which in turn depends upon the ability of home producers to preserve a world-competitive price for their goods. This demands a secure base for production calculations such as can only be given by the

knowledge that some efficient system of control is in operation to ensure that the value of the medium of exchange, *i.e.*, money, will change only to a small degree over an extended period. The American exporter of motor cars referred to earlier would be forced out of business if the sterling price of such cars or the sterling-dollar exchange rate could vary by 10 per cent. in the course of a few weeks or even months.

"Planned" control should not be judged with reference to onerous war-time conditions involving rationing, clothing coupons and queues—and how badly off large numbers of us in this country would have been without them, no matter how fully we exercise our privilege of grumbling !—but on the logical basis of whether or not any suggested State or group "planning" would secure the greatest good for the greatest number without endangering individual enterprise and initiative and without the creation and preservation of a bureaucracy. Again, it is hardly possible to conceive a successful "planned" control in any one country which is not largely economically self-contained, unless accompanied by a large measure of co-operation, if not similar planning, from the countries with which it desires to continue trading and financial relations.

Basically, any such planning postulates the ability of the Government to impose, and the willingness of the people to accept, control of :—

(*a*) The value of the currency in terms of others, which may be accomplished by complete control of the making and receiving of payments to and from abroad, by control as in (*b*) and (*c*), by linking the currency to a precious metal such as gold, or by a combination of all or some of these methods, accompanied in every case by a planned internal monetary and economic (industrial, political and social) policy.

(*b*) the accumulation of capital by nationals and their use of it both at home and abroad, which is essential if anticipatory action to correct economic disturbances is to be taken ;

(*c*) the nature and direction of imports and exports so that the country's purchases are wisely made and its sales effected

to the best of the national, as distinct from the individual, interest ; and

(*d*) emigration and immigration because of their possible effects on the home labour market.

These factors are considered in some detail in the chapters which follow.

* * * *

CHAPTER 2

Mobilization and subsequent control of a nation's external liquid assets—Acquisition by the State of gold and foreign exchange—Subsequent control of dealings in exchange.

UNDER reasonably free international trading and financial conditions the " natural " control mentioned in the previous chapter would come into play whenever, over a period, any country's international balance of payments, *i.e.*, debts of all kinds owed to and by it in respect of all the other countries with which it had trading and financial relations and due for settlement, was consistently favourable or unfavourable to it. In the former case, the competition amongst its debtors for its currency would gradually force up the price of that currency in terms of the others to a point where its exports must fall off owing to the high external cost of its goods (internal price cum rate of exchange) while the plentifulness of money internally, leading to low interest rates, would tend to cause an outflow of investment funds to higher interest centres. Both these factors would tend to cheapen the exchange value of the currency and thus correct the position. In the latter case, the exchange value of the home currency must cheapen owing to competition amongst home debtors to obtain foreign exchange which would at once stimulate exports while the internal scarcity of funds would lead to higher interest rates and bring in investment funds from low-interest centres abroad. The joint operation of these factors would cause an increase in the proceeds of exports

and of the foreign demand for the home currency and so would correct the position.

These correctives are, however, temporary in their effects and, unless the basic causes of the favourable or unfavourable balance of payments are also of a temporary nature, will become less and less vigorous the oftener they have to be repeated. This again emphasizes the need for a certain amount of planned monetary and economic control in order that no temporary derangement of the system may be allowed to become chronic. An early favourite in methods of control of external monetary policy and economic relations was the tariff system. In theory this gave an excellent chance of the permanent correction of an internal defect and had it been recognized as a dangerous drug and prescribed in small doses only it could have done useful service in directing trade (on a reciprocal tariff basis) and would have been far less liable to arouse warlike thoughts in the minds of those against whom it operated most onerously when administered in quantity. But it tended to become more of a political weapon than a piece of delicate machinery for the ironing out of creases in the international fabric of trade and exchange. Basically, of course, any tariff system was aimed at the exclusion of unwanted, competitive, or luxury goods (thus controlling to some extent the national indebtedness to other countries) and, by a system of rebates, drawbacks or open subsidies, at the direction of exports to certain quarters from which a demand for the home currency was desired. Its effect was, in consequence, restrictive of economic freedom.

The evolution of anything like a complete system of exchange control has, of course, been very gradual and many of the early experiments made were subsequently discarded, but all the time it is clear that men's minds were trying to find methods of turning to national use the foreign proceeds of exported products and capital held abroad while at the same time protecting those overseas resources from any undue drain through excessive or unnecessary debts to foreigners being incurred by home residents. Again we see

that the use of money is really confined to its power to act as a purchasing agent of products and services and from the earliest essays the object of any exchange control has been to secure the power to purchase those foreign products and services most essential to the national internal economy.

For this reason, the first step in any attempt at a comprehensive exchange control has always been the mobilization of the country's liquid resources abroad. Subsequent steps proceed towards the conservation and augmentation of those resources. In the initial mobilization, residents are ordered by force of law to declare and to place at the disposal of the State all foreign currency which they hold or which they can claim as due to them by someone abroad, all gold in coin, bars or other commercial form (and possibly silver bars and coin) which they own and all securities capable of being disposed of or redeemed abroad in which they hold the beneficial ownership. Steps to punish hoarding are also usually taken, but they cannot be regarded as successful in countries which have a large and semi-illiterate peasant population such as India and Egypt. The State then has to decide which of these assets it will take over at once and which shall be left in reserve. Obviously those assets capable of realization in the countries to which most is already owed or in which the products and services most immediately essential to the national welfare can be obtained will be the first to be taken over. An arbitrary price of acquisition is fixed by the State, but it must not be too out of line with current external values of the same exchange, metal, or security or a howl will go up from the populace—or at least from that part of it, usually an influential part, which feels it has been unfairly mulcted.

It may be convenient here to point out that, hitherto, any planned form of exchange control has been introduced only by a country faced with a grave national emergency such as a weight of external indebtedness which threatens to overwhelm the national economy, or a state of war. For example, following the trade depression of 1929 and 1930, during which

a heavy fall in the values of primary products took place, Australia and New Zealand introduced an elementary form of exchange control (mainly by rationing buyers of foreign currencies, including sterling) because of the pressing need to conserve their external resources in order to avoid defaulting on their external obligations. Several South American countries, finding that to default on their external obligations did not pay in the long run, had experimented in exchange control for the same reason for some years previously; instances of the methods adopted are given later. Germany, faced with "reparations" payments, developed an elaborate exchange control system ostensibly to accumulate external resources sufficient to satisfy the demands of the victors of the last war, but actually, of course, to assist in her preparations for the next. The home and foreign financial and political crises of 1929 and 1930 forced this country to suspend her gold standard in 1931 and to attempt some management of the external value of the pound. The outbreak of war saw the introduction of a complete system of planned control with the argument that it was rendered imperative by the state of national emergency in which we found ourselves. Similar steps have been taken in most other countries under the urge of providing for total war. It is submitted, however, that measures found essential for the purpose of ensuring that people should be killed are worthy of consideration when contemplating the problem of keeping them alive!

To continue with the main theme of this chapter, the initial mobilization and acquisition by the State of the country's external resources is usually effected by the Central Bank on behalf of the State and the leading commercial banks are as a rule made sub-agents as being in direct contact with the general public. Gold and/or silver in bullion form will be required to be sold to officially appointed brokers or dealers who will account for it to the Central Bank (though neither silver bullion nor coins have been brought within the ambit of exchange control in this country); gold coins will be

called in and retired from circulation by being handed over to the Central Bank as and when they are paid in to a commercial bank, savings bank, the Post Office, etc. Those persons holding or owning the right to foreign currencies must, in the case of such currencies as the State wishes to acquire, instruct their bankers abroad with whom their funds are held, or their foreign debtors, to pay over all such sums to the local agents of their home bankers who, in turn, on receipt of advice from their foreign agents of any such amounts having been placed to their credit will give instructions for them to be transferred to the local agents of their home Central Bank. When advice of such transfers is received by the Central Bank it will pay over to the commercial bank concerned the equivalent in home currency of the foreign currency so handed over and that bank will then credit the account of the former owner. Where it has been the practice of a company, firm, or individual to maintain accounts abroad either with foreign banks or with local branches or agents for specific (particularly business) purposes, they may be granted by the authorities exemption from the surrender of such of their foreign assets as may be regarded as essential for the continued conduct of business or the maintenance of property or other approved purpose abroad. In such cases official supervision over the use of such assets will be imposed by requiring the owner to render periodic statements of account duly certified in the foreign centre, and surrender will be called for of any sum which may be accumulated and is regarded by the authorities as surplus to the normal foreign requirements of the owner, consideration being paid to the growth or contraction of the foreign activities of the owner.

At the outset of these processes the authorities will have announced official prices at which the Central Bank will buy or sell specified foreign currencies and buy gold and/or silver bullion. The prices for the latter must be based within a little on world prices for these metals (to discourage smuggling) but the prices for dealings in foreign currencies, the official

rates of exchange, require far more consideration. The authorities must decide :—

(*a*) from which other countries the most essential goods and services, *e.g.*, shipping, must be obtained ;

(*b*) what is the probable maximum value of exports which the home country can make and the foreign country absorb at a given rate of exchange ;

(*c*) what rate of exchange will give the maximum impetus to exports without unduly raising the cost of essential imports ;

(*d*) what will be the reaction of the foreign country to any proposed rate of exchange (too great a cheapening of the home currency in terms of one foreign currency and not of another might well provoke hostility in the one because its non-essential exports would be made too dear to the home buyer and in the other because its essential imports from the home country were not being made cheap enough) ;

(*e*) for how long the national resources in a foreign country, when mobilized, will prove sufficient to bridge any gap between the probable cost of imports and proceeds of exports at the proposed rate of exchange ; and

(*f*) which foreign currencies shall at once be the subject of State acquisition and so will require the fixation of official buying and selling rates, which of them can be left for the time being but are likely to be the subject of similar action in due course, and which of them are of so little importance as to render the need for State acquisition improbable so that rates of exchange for such currencies can be left to be thrashed out by the normal operations of the open market.

When the decision as to what currencies shall be requisitioned and what official exchange rates shall be fixed for such currencies in terms of the home currency has been taken, it must be given the force of law, and public orders issued to announce the fact. Thereafter, all purchases and sales of the specified currencies against the home currency must be effected through the Central Bank or its appointed agents and such dealings will be allowed only for the purpose

of carrying out transactions which meet with official approval. Various methods of examining the purpose underlying any proposed purchase or sale of a specified currency by home residents have been adopted, but since payment for imports and the receipt of the proceeds of exports are of the first importance, steps are usually taken to make the exchange operations in respect of such trade as easy as possible and to rely on a system of licences for both imports and exports as the main machinery of control. These aspects are dealt with in greater detail in succeeding chapters but mention may be made here of the practice adopted in some countries of reinforcing the inducements or deterrents offered by the licensing system by the fixation of different exchange rates for various classes of imports and exports, *e.g.*, a rate dearer for less essential than for essential imports may be fixed so that the internal cost to the importer of non-essential goods is increased possibly to an extent which would prevent his eventual selling price from being sufficiently competitive with the prices of home-produced goods of a similar nature. Exchange operations in respect of charges and expenses incidental to the movement of goods, *e.g.*, freights, insurance premiums, port dues, etc., are usually given similar consideration and made as easy as possible.

As regards exchange relating to transactions of a financial or personal nature, any system of control requires that a special application to the Central Bank or to one of its agents shall be made in order that purchases of exchange shall be confined to really necessary transfers and that all exchange arising out of such items and accruing to residents shall be turned over to the State in the case of specified currencies. The degree to which transfers of funds abroad are allowed for personal requirements such as maintenance of relatives or friends in other countries, foreign travel, gifts to charities or individuals, etc., must depend on the extent to which it is imperative to conserve the country's external resources; in time of war applications of this description undergo the closest scrutiny and are necessarily cut to a minimum.

Proposals involving the transfer of capital abroad are, of course, subject to searching investigation and, in time of war, can only be permitted where they can be shown immediately to further the national interests.

As we are dealing with principles it is unnecessary to go into further detail as to the treatment which may be accorded to various types of this class of transaction and it is sufficient to say that this varies with the official view of the availability of external resources and of the extent to which the proposed transfer can be said to be essential to the welfare of the country even by way of prestige or morale. The basic principle is that having concentrated in the hands of the Central Bank, on behalf of the State, the liquid assets owned in certain foreign countries by residents and having fixed official rates of exchange for dealings in the currencies of those countries, the authorities must ensure that all sums in those currencies accruing to residents are offered for sale to the State so as to swell the pool of external resources and that withdrawals from that pool shall take place only with official cognisance and permission. A Postal Censorship is a usual concomitant in order that the control of exchange and trade transactions may be more effectively applied. Penalties enforceable at law on all evasions of the decrees or clandestine dealings in exchange must also be imposed but even so a "black market" in exchange is by no means an impossibility unless the control is operated honestly and fairly and every precaution taken to close all loopholes. Otherwise the legal penalties must become drastic. When Dr. Hjalmar Schacht, who was the Currency Commissioner under the German Republican Government in 1923, decided to throw in his lot with Hitler, he was made Minister of Economy and was virtually the economic dictator of Germany until 1937. In the course of evolving the very elaborate system of exchange control which he considered the requirements of the Reich demanded, he insisted on the passing of laws imposing the *death penalty* on anyone discovered attempting without permission to send money of any kind out of the Reich,

transferring to a foreigner the right in any form to gold or foreign exchange or omitting (even by negligence or ignorance) to disclose to the Reich authorities a beneficial ownership of or interest in possessions abroad. And there is plenty of evidence of the strict enforcement of these ruthless decrees !

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CHAPTER 3

Grouping of countries for control purposes—Fixation of exchange rates by bilateral government agreements—Official exchange "clearings"—Barter and Lend-Lease arrangements.

ANOTHER major point to be considered under any system of exchange control is the "grouping" of countries. Obviously the more extensive the area over which the control operates the greater will be the variety of goods and services which can be furnished internally and the less will be the need for essential imports from outside the area ; this, of course, pre-supposes that the price paid for supplies obtained from within the area is of secondary importance to the need for conserving foreign exchange resources. Similarly, if any one rate of exchange or set of arrangements can be made to cover a group of countries instead of having to be adapted to cover each of those countries individually, there will be a corresponding easing of the restrictions which must follow bilateral as opposed to multilateral trade.

For example, the pre-war Payments Agreement between France and Germany was adapted not only to Metropolitan France but to the whole French Colonial Empire as well, which gave a much stronger bargaining power to France when the agreement was under discussion. In the case of this country when a complete system of control was introduced on the outbreak of war, the whole of the British Commonwealth of Nations, the Colonies, Dependencies and Mandated Territories (with the exception of Canada, Newfoundland, and Hongkong), were brought within the scope of the control

and formed a group known as the " Sterling Area." The exceptions named were made owing to their contiguity to countries in which no control was in operation or was only partial and through which evasions of the " Sterling Area " control would have been comparatively easy. Each of the exceptions, however, at once adopted a parallel system of control and for some time before its capture by the Japanese Hongkong had been included in the " Sterling Area." The self-governing Dominions, Australia, Eire[1], New Zealand and South Africa, issued their own control decrees and were autonomous in their administration but they worked on the same lines as and were, in fact if not in name, a part of the United Kingdom control. Egypt, although an independent country, at once came into the " Sterling Area " and operated a control on the same lines and in close relation with ourselves. The rest of the Empire, of course, was directly under our control. With the dismemberment of Europe and the varying adherence of the colonial possessions of our Allies to our cause, certain territories have from time to time been added to or taken away from the " Sterling Area." These, however, are again matters of detail and are used only to illustrate the principles. It may be mentioned in passing that the term " Sterling Area," or " Sterling Bloc," was used before the war to describe an area the countries in which (mainly Scandinavian) had decided individually to base the external value of their respective currencies on that of the pound sterling, which necessitated " management," *i.e.*, control, of the various exchanges by the Central Banks concerned.

While the country operating a system of exchange control is of course at liberty to fix arbitrarily such rates of exchange between its own currency and others as it may deem expedient the control will be less subject to evasion and friction if the rates fixed bear a reasonably close relationship to the current ratio between the internal purchasing power of the two currencies concerned or if the other country is ready to admit

[1] Eire is no longer a self-governing Dominion but has become an independent (*sic*) Republic.

the propriety of the proposed rate and to co-operate to the extent of making a corresponding rate effective within its own borders. For example, in 1938 a " Payments Agreement " was concluded between Hungary and Rumania under which the rate of exchange applicable to all trading transactions between the two countries was fixed at Lei 26·50 to Lei 27·00 per pengo. The Hungarian authorities would sell Rumanian currency for trade purposes at Lei 26·50 per pengo or buy that currency at Lei 27·00 per pengo while the Rumanian authorities bought Hungarian currency at Lei 26·50 per pengo or sold it at Lei 27·00 per pengo, but these rates were obtainable only by residents in the respective countries and then only for genuine trading transactions. This principle was followed in the case of the arrangements made between the authorities in this country and the U.S.A. in 1940 when in consideration of certain underlying guarantees between the parties it was arranged that the authorities here and those in the U.S.A. acting as agents for the former would buy or sell in unlimited amounts dollars against sterling resulting from current trade or financial transactions between the two countries at rates of $4·02½ per £ for sales of dollars against sterling and $4·03½ per £ for purchases of dollars against sterling. A new type of sterling account known as Registered Sterling was also created to which credits could be passed by permission of our authorities and balances on which could be used to make certain permitted payments or could be converted into U.S. dollars on application to the authorities at the official exchange rate then current. Although a similar type of *sterling* account was arranged with Switzerland at the same time, balances on which were convertible into Swiss Francs at the current official rate on application to the authorities here, no arrangements were made for the conversion *in Switzerland* of sterling into Swiss Francs at the official rate ruling here.

A variant of this principle takes the form of a bilateral agreement under which it is arranged that the currency of one of the countries only shall be the medium for the settlement

of current trading and financial obligations between the two countries. This involves the creation of a special type of its own currency by the country concerned and which is not available for purposes other than those set out in the agreement. This type of arrangement is discussed more fully in Chapter 5, but it may be said here that as the currency of one country is used as the denominator of value of the common current interests of both, that country is not immediately concerned with the value of its own currency in terms of the currency of the other country, *i.e.*, the rate of exchange. It is for the other country to fix the rates at which it will buy and sell the currency of the other party in terms of its own currency but necessarily there must be a measure of consultation and accord between the two parties as to the rates to be adopted or the smooth working of the arrangement would be endangered.

An even more rigid arrangement is that provided by "exchange clearings" set up under a bilateral agreement between two States. Such a scheme requires that the authorities in each of the contracting States shall set up machinery for the collection and payment of debts due to and by each other and as from a published date, residents in each country must pay or claim in their own currency to or from the Clearing Office in their own country all trading and/or financial debts accruing due to or by them in their transactions with residents in the other country; residents in the other country similarly must pay to or claim from their own Clearing Office in their own currency debts resulting from their transactions with residents in the first country. Obviously, a payment into one Clearing Office will be countered by a claim lodged with the other. Thus, if an "exchange clearing" is set up between countries X and Y for the settlement of all debts accruing due between them on and after a certain date, an exporter of goods from X to Y would thereafter be compelled by law to complete a form of claim on his buyer in Y, possibly accompanied by the relative shipping documents and a bill of exchange, and to lodge it

with the Exchange Clearing Office in his own country. The Office in X will pass on particulars of the claim to its counterpart in Y and in due course the buyer in Y will apply for permission to settle his debt which he will do by paying to the Y Office a sum in domestic currency sufficient to purchase the required sum in the currency of X at the official rate of exchange for Clearing transactions. At the same time exporters in Y will be sending goods to or shipowners will have freights, etc., to claim from buyers in X and will lodge claims with the Y Clearing Office, while the X buyers will eventually pay into the X Office sufficient of their own currency to discharge the debts due in Y's currency at the official rate on their side. Each Office, therefore, receives and pays its own currency; it collects enough of its own currency from debtors to meet the cost to the other Office of paying the local creditor in domestic currency and uses these collections of its own currency to effect payments to home creditors on the instructions of the other Office.

To cover the cost of administration a charge on all payments to residents is usually levied by each Office, *i.e.*, the creditor pays a commission for the collection of his debt through the Clearing Office. Either a single rate of exchange operative in both countries may be fixed or each country may fix, in agreement with the other, its own rate of conversion of the foreign into domestic currency. The former method is adopted either where the balance of payments between the two countries is in reasonable equilibrium and it is not desired to induce or deter trade one way or the other or where one country is imposing its will on the other and wishes to fix an exchange rate most advantageous to itself. This is well instanced by some of the Exchange Clearings imposed by Germany on the Occupied Countries, and even on some of her allies, under which a rate of exchange was arbitrarily fixed which greatly overvalued the Reichsmark in terms of the other currency. If, for example, the relative internal purchasing power of the two currencies showed an exchange rate of Dutch Fl.60 to RM.100 and a Dutchman

sold for RM.100 an article worth to him (from the point of view of internal purchasing power) Fl.60, he would acquire an equivalent purchasing power with his RM.100. But if an Exchange Clearing is set up by Germany under which a rate of Fl.80 to RM.100 is fixed, it means that a Dutch seller would have to furnish Germany with goods representing Fl.80 worth of purchasing power in Holland against the receipt of RM.100 only, and which, in purchasing power, represents the equivalent of no more than Fl.60. Similarly, a Dutch buyer forced to import goods from Germany must part with Fl.80 in order to obtain goods priced at RM.100, but which, in internal purchasing power, represent to him no more than he could have obtained by the expenditure of only Fl.60 in Holland. This is no more and no less than robbery under arms and constitutes an excellent example of a good emergency principle put to a bad use.

Where, by mutual agreement, each party to an Exchange Clearing fixes its own rate for the conversion of the other currency into its own, the object is usually to promote trade in one direction and to deter it in the other. For example, if country A is greatly in need of natural products of country B, but B, being impoverished, wishes to keep its imports to a minimum so as to restore its external finances and an Exchange Clearing is arranged between them, it may be agreed that B shall charge its own residents 12 units of home currency for each 5 units of A's currency paid out through the Clearing in A, but that A will collect 6 units of its own currency for every 12 units of B's currency paid out through the Clearing in B and will also accept B's currency from official quarters in B at the same rate. This means that the authorities in B are selling A's currency to home buyers at 5 A for 12 B and receiving back 6 A for 12 B so that ultimately a credit balance in A's currency is built up.

A variant of this principle is exemplified in the terms of a supplementary agreement entered into between this country and Turkey in May, 1938, which amended the terms of the

original Trade and Clearing Agreement between them of September, 1936. The amendments provided, *inter alia*, that, with the exception of certain specified items, all sums paid in sterling into the Turkish Clearing Account in this country should be available only as to 70 per cent. for the discharge of current commercial debts due to us by Turkey and that the balance of 30 per cent. should be made available to the Turkish Government for the purpose of meeting its external obligations. This meant that Turkey could only afford to import from us goods and services to the extent of 70 per cent. of the value of her similar exports to us. British creditors, therefore, had to wait for the discharge of their debts in full (payments " on account " were invariably made through the Clearing) until the external requirements of the Turkish Government had been satisfied and a reserve accumulated when increased amounts of sterling exchange could gradually be released to Turkish debtors. Obviously such a system has undesirable results and should be only a temporary expedient in a time of emergency. Trade ledgers should always be balanced eventually and a steady accumulation of an unpaid margin of debt which must result under such a scheme as this can be balanced only by throwing the loss on to the foreign creditor or by the raising of a loan in the creditor country by the debtor government which must be slowly and laboriously repaid.

In this connection the Anglo-Italian Exchange and Payments Agreement of November, 1936, made provision for the gradual extinction of arrears of commercial indebtedness due to this country by Italy and her Colonies by allotting certain percentages of current payments of sterling in respect of debts just falling due to special " Arrears " accounts to which were carried varying types of outstanding liabilities. Thus of every £100 becoming payable by a British debtor to an Italian creditor on and after a given date, only £70 went to the new Clearing account while £18 went to the highest graded " Arrears " account, £9 to the next highest and £3 to the lowest. The system of licensing of imports of goods

then in force in Italy, however, enabled the Italian authorities so to adjust the volume of their imports from as against their exports to this country as to provide for the agreed margin of 30 per cent. while still meeting current maturing debts in full. Incidentally, this Agreement also affords an example of the principle of one only of the two countries concerned being given authority to fix the rate of exchange to be used for Clearing payments. The Clearing Office in Italy fixed the rate which Italian debtors must pay in lire to obtain sterling payment of their sterling debts and at which Italian creditors must accept payment in lire in discharge of debts due to them in sterling while Rome also advised London of the rate at which debts due in lire by parties in this country to Italian creditors must be converted into sterling and collected through the London Clearing Office. This arrangement was probably adopted to assist Italy in the control of her imports.

A much more primitive and restrictive arrangement is that of a "Compensation Agreement" which is in effect and sometimes in fact pure barter. This principle again can be illustrated by reference to Turkey which had (and probably still has) "Compensation Agreements" with Bulgaria, Denmark and Japan. Under these Agreements, Turkish importers of goods from the country concerned paid the equivalent in Turkish pounds of the foreign currency amount of the invoice at an officially fixed rate of exchange, into a "blocked" account with the Central Bank. These blocked funds had to be used within a limited period by the foreign owners in payment of goods purchased in Turkey; if not so used the funds became blocked indefinitely. This meant that a Bulgarian exporter, for instance, would hardly dare to send his goods to Turkey unless he were reasonably sure of being able to use the proceeds in the purchase of Turkish goods which would command a ready and profitable sale in his own country. The restrictive nature of such Agreements need not be stressed but all the foregoing examples show clearly the influence of commercial interests and national needs on the system of exchange control adopted.

It is, of course, possible to carry on a limited amount of trade and business by means of barter, *i.e.*, the exchanging by one with another of goods or services without the use of some form of money, but it is a cumbersome and difficult process which it would be almost unthinkable to regard as possible for use in ordinary life. Imagine a fisherman with a catch of herring who wanted a new pair of trousers going the round of the shops to discover an outfitter sufficiently fond of herring to be willing to exchange a pair of trousers for some! And then would arise the nice point of what quantity of herring would be regarded by both parties as fair value for the trousers. By the time negotiations were completed the fisherman would probably find himself in possession of a depreciated currency instead of a new pair of trousers!

While trade by barter is still carried on with primitive peoples it is rarely encountered between modern trading nations and then only under pressure of conditions of unusual emergency. For example, following the war of 1914-1918, Germany and the Central European nations were so impoverished that there was universal distrust of their respective currencies and foreign exporters refused to sell to them save in terms of foreign currencies which the would-be buyers could not find. Several sets of arrangements were made, therefore, either between governments or influential groups of traders to enable the immediate essential wants of the vanquished countries to be met. Germany exchanged coal with Finland for timber and with Sweden for iron ore. Austria and Hungary sent agricultural produce and textiles to Rumania for oil, etc. In a smaller way, distrust of her currency inside Germany herself in the early 1920's led to such a constant and erratic rise in prices that the people began to resort to barter to meet their everyday needs, one kind of produce or goods being exchanged for others by their respective owners. This certainly goes to prove that the sole use of money is to act as a purchasing agent and as a denominator and store of value. If money fails, other means are found to keep alive the vital spark of commerce.

This fact has been more recently illustrated by war-time arrangements between Great Britain and her Allies and the U.S.A. When after the fall of France it was evident that the war would be prolonged and that our resources in the United States were by no means inexhaustible, some way had to be found of keeping up supplies from America even though no immediate payment could be forthcoming and without renewing the sour taste left in the mouths of many Americans by what they considered our default on our indebtedness from the last war. In this we see again the shortcomings of money unless some form of planning is adopted to avoid variations in its purchasing power, in that our debt to America for goods supplied to us during a time of sky-high prices, when expressed in terms of money, required the production and sale of a much greater quantity of goods at a lower level of prices in order to effect payment of the money debt. To avoid a repetition of the imposition of such an onerous burden President Roosevelt conceived a new idea which he called Lease-Lend. Under this scheme the Allies did not become the owners of the war supplies sent to them by America but undertook in due course to return supplies not destroyed, used or worn out. The precise details of the scheme are not public knowledge but the principle is clear. With the entry of America into the war she in turn became in need of goods and services which the Allies could supply and Lease-Lend has since worked both ways. We were told at the time that no narrow accounting in respect of Lease-Lend transactions was to be made but all parties were putting all they had into the common pool and charging the cost to their own war bills.[1] If only the peoples of all the Allied countries had accepted this principle of common effort and sacrifice for a common end when it came to "picking up the pieces" what endless haggling as to the value of a bale of cotton in terms of boys' lives would have been saved !

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[1] See p. 111.

CHAPTER 4

Mobilization and subsequent control of external investments—Acquisition of foreign securities owned by home nationals—Control of the domestic capital market—Control of foreign investment in that market—Control of withdrawals of capital from that market by foreign owners.

IN synchronization with the mobilization of a country's liquid assets abroad on the introduction of anything like a complete system of exchange control, steps must be taken to mobilize negotiable securities payable in terms of any of the " specified " currencies or capable of being sold in the market of any one of the countries whose currencies have been so specified. A decree must be promulgated requiring owners—not merely registered holders, nominees, or bailees but those residents who ultimately have the power of disposal over such securities—to register with the authorities full details, including definitive numbers, etc., of all securities included in a published list of which they are, in fact, the beneficial owners. The physical labour of recording the resulting registrations is usually carried out by the Central Bank with the assistance of the commercial banks as sub-agents. When the State decides to acquire any given security at an arbitrary price the Central Bank will pay the owner or his bankers in domestic currency the value at that price of such securities as are handed over in a form which constitutes a " good delivery " in the foreign market in which they are likely to be disposed of, together with all necessary documents of transfer. The securities, which are then the property of the State, may be sold on its behalf by the Central Bank through its agents in the relative foreign centre or may be used as security for advances made by financial groups there. In either case the sales or loan proceeds are received in the foreign currency and credited to the Central Bank's account with its local agent, thus helping to swell the nation's store of liquid external resources.

The immensely strong creditor position in regard to other

countries built up by this country over a long period of years had led to financial operations and investments of all kinds abroad and many foreign concerns were wholly owned or largely controlled by parties in this country. Soon after the outbreak of war such interests became the interests of the State in that they represented potential external assets. An extension of a step previously tried out by Germany was therefore decided upon and special arrangements were made for the conversion of such assets into liquid resources either by temporary pledge or by outright sale, the British owners being consulted as to the values proposed and compensated by payment in sterling of the equivalent of the foreign exchange obtained by the eventual sale or pledge to foreign interests of the participation concerned. At the time of writing no steps have been taken in this country to require the registration and possible surrender of foreign assets such as life or endowment insurance policies, real estate, or other property and these therefore still constitute a further reserve of mobilizable external resources. Should any such assets become liquid by sale or maturity in terms of a " specified " currency, however, the owner must offer such proceeds for sale to the authorities.

It must be pointed out here that all operations of the nature outlined above actually result in a repatriation of capital to the home country and careful internal monetary management is an essential accompaniment if dangerous inflation of the domestic credit system is to be avoided. In ordinary circumstances a sale by a resident of one country of his capital interests in another country to a resident of that country requires a conversion of the currency of the buying into that of the selling country if the seller wishes to bring his money home. In any volume such capital transfers and consequent exchange operations would tend to cheapen the buying country's currency in terms of that of the seller. This would induce an increase in imports and a decrease in exports as between the selling and the buying country and were they both on a gold standard might even result in gold being

shipped from the debtor to the creditor country. In either case the country which originally sold the capital interest would eventually receive payment in the form of surplus imports of goods or an influx of gold. The former would adjust the position automatically because the owner of the capital would receive his money indirectly from the purchases of foreign goods by fellow residents which would come to him through the off-setting nature of foreign exchange operations conducted in free markets, accompanied by a credit ease in the receiving country and a stringency in the other which might call for remedial measures by the monetary authorities on both sides. The latter would certainly require the intervention of internal monetary management if domestic credit inflation were to be avoided since the gold influx would enlarge the credit base in order that the capital debt might be discharged, *e.g.*, if half a million pounds worth of gold comes into this country because five people here have each sold £100,000 of securities abroad the gold will be sold to the authorities and the proceeds (representing the creation of new money against the increased gold holding) will be placed to their credit in the home currency.

Where, however, capital assets held abroad are turned over to the State for national use the sales or pledge proceeds are disbursed in the foreign country by the State in the acquisition of essential supplies and services and the foreign exchange market remains untouched. The possible compensatory action of an alteration in the flow of trade between the two countries mentioned in the previous paragraph would therefore take full effect in such circumstances in that the State creates new currency or credit with which to compensate the owners of the securities and eventually receives there-against foreign goods and services. But until all or part of those items can be sold back to its nationals by the State and the proceeds retained in its own coffers or used to cancel a large part of the previously created credit, the dangers of inflation are evident and prompt and efficient steps must be taken by the authorities to absorb or to direct

into national needs the bulk of the credit which they create for such a purpose.

Moreover, most of such capital investments abroad yield a useful annual income to the home country in the shape of interest or dividends which, being paid in the foreign currency, are available either for re-investment there, or to pay for imports of goods and services or to offer for sale in the open market and so create a supply of foreign exchange and a demand for the home currency. The sale to foreign interests of such capital assets immediately cuts off the income therefrom so that in course of time, *e.g.*, 20 years on a 5 per cent. simple interest basis, the immediate gain of liquid resources by the sale of capital is progressively outweighed by the loss of income for an indefinite further period.

It is usual for steps also to be taken by the authorities to control both the investment at home and abroad of domestic funds and of foreign-owned funds in the home market. One of the first essentials is so to direct existing domestic liquid capital and further savings as to ensure that they will be employed to the full in the furtherance of the national interests. This means that individual initiative and liberty to invest must be strictly curtailed. It must be remembered that any purchase of securities by a home resident from a foreigner involves either the placing of domestic currency at the disposal of the foreigner or the purchase by the home resident of the foreigner's currency. In each case the effect is adverse to the home country and such security purchases must be regarded by the authorities as they would regard applications for permission to import goods, *i.e.*, whether the proposed import of securities is essential or non-essential. Consequently a licensing system is usually adopted under which any proposed purchase by a resident of securities in which a foreigner has a beneficial interest must receive the prior approval of the authorities through one of their authorized agents. This system has a double effect. It prevents the transfer of capital abroad without authority in cases where a resident proposes to purchase a security which

is only marketable abroad and equally it prevents the withdrawal by foreigners of capital from the home market through sales (even at a sacrifice) of securities saleable on the home market. It is always open to the authorities to licence the purchase by residents of securities in which a non-resident interest is held provided that such a purchase is regarded as being in furtherance of or at least not inimical to the national interest and discrimination can be exercised to prevent the unwarranted transfer to foreigners of rights to the home currency which must result from such transactions. It also gives the authorities the opportunity of permitting where desired a supply of the home currency on an exchange market abroad, which may be the case where home exports of certain goods need to be fostered and the foreign country concerned offers a ready market for such goods, but is inherently unable for the time being to supply any necessary imports. An export industry may need to be kept active with a view to its post-emergency possibilities regardless of the immediate direction of its sales. Attention is thus called again to the need for correlating and even subordinating all other activities to the vital need for the preservation and, if possible, the extension of international trade and commerce. Products and services are the only tangible form of wealth and means of subsistence.

The state of emergency necessitating the imposition of exchange control usually also requires a mobilization of internal as well as external resources and the tendency is towards measures which will direct or even coerce idle capital and further savings into State loans of both a long and short term nature. To this end a controlling body is set up, to which all applications for permission to raise fresh capital must be submitted, whether on public or private behalf. The co-operation of the domestic stock exchanges must be enlisted so that no new security becomes eligible to be dealt in unless the issue has been officially approved. Even what is known as " private placings " must also be subject to the prior approval of the controlling body but a minimum figure is usually fixed below which reference to that body is unnecessary.

The whole object of restrictions on dealings in securities between home residents and foreigners is to prevent transfers of capital into foreign ownership either by a " flight " from the home into a foreign currency by residents (as where a British resident sells War Loan to another British resident and uses the proceeds to buy a stock or share or debenture negotiable only in the U.S.A.) or a " flight " from the home currency by a foreign investor (as where a resident of Brazil wishes to sell British securities, which he has held for some time before a state of emergency arose in this country, in order to have the proceeds made available to him in his own country).

The object of restrictions on new appeals for capital internally is to prevent the undue or even unnecessary diversion into industrial or financial channels of available funds which national interest demands should be loaned to the State and utilized by it in payment for essential supplies or other internal obligations.

On the other hand, the purchase by a foreigner of domestic securities out of liquid domestic funds which he already owns is to be encouraged. Every such purchase results in the conversion of a short term into a longer term debt since a liquid balance can ordinarily be disposed of by a foreign owner by a sale of the relative currency on the exchange markets of the world to the immediate detriment of the currency concerned. If such a purchase of domestic securities is made from a resident, the ownership of the liquid funds changes from foreign to domestic and of the securities from domestic to foreign. *A priori* the foreigner would not change his liquid assets into a more fixed form unless he were prepared to leave his capital abroad for an indefinite period and the former domestic owner of capital in the form of securities has now rendered it liquid—in which form it can more easily be directed into State requirements.

Where a foreign owner of domestic securities sells them to another resident of his own country, the liability of the home to the foreign country remains unchanged. But if an owner

in country A of securities of country B wishes to sell them to a resident in country C, it becomes for B an exchange problem and permission for the deal must depend upon whether B would rather have a capital claim upon it by C instead of A. A comprehensive system of exchange control, therefore, requires a licensing system under which any change of ownership of a domestic security which involves the creating or relinquishing of a foreign interest in that security is made subject to official scrutiny and approval. Transfers between residents of two foreign countries must be sanctioned only if the home country is better able to support a balance of indebtedness to the buying than to the selling country. Transfers by a home to a foreign resident are especially to be welcomed if the buyer pays for his purchase either out of funds already at his disposal in the home country or by acquiring such funds by purchase against a sale of his own currency. In either case the home position is benefited as foreign-owned home funds must be transferred out of that ownership to that of a resident. The internal liquid position is thereby increased and an additional potential source of subscription to State loans set free.

Where a foreigner voluntarily acquires domestic funds by a purchase of home currency against a sale of his own and invests those funds in domestic securities, it is usual to recognize such a gesture by giving the foreign investor the right to realize the security and to utilize the proceeds in the re-acquisition of his own currency at any time he pleases by placing an endorsement to this effect on the licence issued to him at the time of purchase. He is then entitled to exchange into his own currency the proceeds of any ultimate sale of the securities in terms of the home currency, subject only to conditions ruling at the time when such an operation is desired. A country jealous of its international reputation would be most careful not to jeopardize its good name by repudiating any such undertaking or, except under conditions of extreme duress, by placing any obstacles in the way of the unrestricted repatriation of such foreign capital with the

minimum of exchange as distinct from investment loss. The Regulations in this country have been most carefully designed to such ends and may serve as a model to others who, should such dire circumstances again arise, may be forced into the adoption of similar methods.

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CHAPTER 5

Control of uses of domestic currency by or on behalf of foreign owners —Canalization of international payments by bilateral agreements —" Frozen " and " blocked " funds.

To reinforce such restrictions as may have been placed on the withdrawal of foreign-owned capital by means of the realization of stock exchange securities, a comprehensive system of exchange control requires that the withdrawal of foreign-owned capital held in other forms, *e.g.*, real estate, mortgages, deposits with banks or financial houses, building societies, etc., shall be similarly restricted. Administrative difficulties render undesirable any system of licensing of the transfer of such assets from one party to another and it is usual for the necessary restrictions to come into play only when such transactions reach the stage where funds must be transferred from one to the other in order to effect settlement.

Transfers of such assets between residents can proceed unhindered but a transfer between a home and a foreign resident or between two foreign residents will involve a transfer of funds abroad or a credit to a non-resident account, both of which operations require official approval under the normal working of an exchange control. Opportunity can then be taken to prevent any withdrawal by a foreigner of realized capital assets and the usual method is to require that such proceeds shall be credited to a " blocked " account in the home currency to be opened with a home bank. The balance on such an account cannot be used by the account holder except for a very limited purpose which is usually

confined to the investment of the funds in any of an officially compiled list of securities. The eventual income from such securities (as with all income from foreign-owned home investments) is usually eligible for transfer to the owner in his country of normal residence or to the account of a bank or party resident in that country.

This principle is best illustrated by reference to Germany. By the end of 1934 (probably as the result of the ruthless intelligence of Dr. Schacht), restrictions on the withdrawal and even on the internal use of foreign-owned assets had resulted in the creation of five different kinds of " blocked " marks and four different kinds of marks for the use of foreigners, only one of which was entirely free of restrictions on its transfer. But even if marks of this latter type were used in transactions of which the proceeds were regarded as of a restricted type they lost their " free " status and assumed that of the restricted type. Since these various types display a certain variation of treatment it is interesting to tabulate their main features. Starting with the premise that if a foreigner thought the country previously was good enough for him to leave his money in, whether in the form of securities or other investments or as cash balances, it was good enough for him to have no reason to change his mind, the German authorities made orders to the following effect, as regards investments made or cash deposited in Germany prior to 16th July, 1931.

(1) The proceeds of the realization of capital in the form of domestic securities, real estate, mortgages, liquidations, repayment of " credit lines," etc., could be credited only to a " blocked Credit Mark " account. The balances on such accounts could be used only for the purpose of investment in German securities (with a few exceptions) or, subject to a permit, for credits to, or participations or investments for a period of at least five years in German enterprises or for mortgages on or purchases of real estate in Germany ; they could also be used for gratuitous payments in Germany, *e.g.*, charitable donations or assistance to relatives or friends and to a very limited extent for the travelling expenses and

maintenance in Germany of the account-holder and his family and servants. Finally (and the only concession of interest to a person wishing to repatriate his capital), such balances could be used in payment of not more than 25 per cent. of the invoice value of goods manufactured from at least 80 per cent. German raw products to be exported from Germany to the account-holder for his own use. This type of " blocked " mark was still in existence at the outbreak of war and attention is drawn to the last concession in particular as showing the close relationship between financial decrees and the imperative need to induce exports of mainly home-produced goods at any cost. A concession such as this, however, invites the creation of a " black market " in the particular type of " blocked " domestic currency since financial investors or speculators as such are seldom inclined to indulge in transactions involving the actual purchase or sale of goods but are willing to sacrifice their purely financial interests by selling them at whatever price (in terms of their own or some other desired currency) they will fetch to a party who can make use of them for a commercial purpose.

(2) " Old " Credit Balances. Balances on accounts, whether in marks or any foreign currency, kept with Germans by foreigners and remaining unchanged since 16th July, 1931 (note again the premise that assets which had been allowed to remain in Germany or under German control for three years of political and financial disturbance are in question) were regarded as " old " credit balances and, as such, were available to the owner only for the purposes set out in (1) above except that a permit was required in the majority of cases before actual use could be made of such funds.

On 1st of January, 1939, new decrees were issued which gave increased privileges to foreign owners of assets falling within the categories covered by (1) and (2) where such assets had been held for not more than one year, or for longer in certain special instances, but the principle that intended indefinite loaning or depositing of funds in Germany carried with it a loss of the right of withdrawal of such funds for the

time being was still preserved. This basic principle has been accepted to a large extent by the authorities here in the present state of emergency in that investments by foreigners in British enterprises prior to the outbreak of war, whether in the form of shareholdings, finance by way of loans or goods on consignment, liquid funds left on current account which are consequently available to the depositee (other than a bank) for business purposes and have been so used, are not regarded as eligible for free transfer to the owner in his country of normal residence or elsewhere.

(3) All balances belonging to persons formerly resident in Germany but who emigrated from that country after 3rd August, 1931, *i.e.*, three years earlier, became blocked and could only be used under permit for approximately the same purposes as funds blocked under (2) above.

(4) All balances in favour of a foreigner deriving from remittances into Germany from another country in the form of German notes or coin or Reichmark bills after 19th February, 1932, became blocked but could be put to the same uses under the same conditions as funds blocked under (1) above.

(5) All amounts resulting from the sale of securities by or their redemption in favour of a foreigner had to be credited to a Security Proceeds Block Account. All interest and dividends deriving from such securities had also to be credited to such an account unless they were paid into the Conversion Bank for German Foreign Debts on behalf of the owner—in which case he got his money if and when the authorities issued a permit for its conversion into the owner's own currency. Broadly speaking, such balances could be used as in (1) above.

In 1934 there were also the following types of marks in official existence :—

(*a*) Free Reichmark Credit Balances which consisted of funds deriving from actual sales of foreign exchange to the German authorities by the foreign account-holder or from transfers or payments from an existing " free account ".

Such balances could be freely disposed of by the foreign owner even for payment of German exports (*but see earlier*).

(*b*) Registered mark balances which arose out of the fractional payment by the German authorities, under the various "Stand-still" Agreements, of sums due to foreign creditors. Such balances could be invested without a permit in German public or private securities or in loans or investments conducted through an authorized German Bank.

(*c*) Special Travellers' Accounts could be opened by transfers from a Registered Mark Account. The use of such accounts was limited to RM.50 per day per person unless a recommendation from an authorized bank was obtained when the amount might be increased to RM.100 per day per person. Internal railway fares could also be paid from such accounts, but the users had to be private travellers to enjoy any of these concessions; withdrawals were checked by the amount drawn being entered in the traveller's passport by the paying banker. These marks could be used to furnish maintenance for persons taking a course of study in Germany.

(*d*) Foreigners' Special Accounts for Payments in Germany which were devised to facilitate trading and barter transactions with those countries with which Germany had no Clearing Agreements. Such accounts could be opened by a payment from a German resident in respect of a permitted import of goods from the foreign account holder. The balances on such accounts could be used by the account-holder in payment for goods imported by him *and no other* from Germany or for paying internal charges, *e.g.*, carriage and handling charges, on such goods. In the case of certain countries, notably in South and Central America, it was possible for such accounts to be opened in the names of banks in those countries to which the proceeds of permitted imports into Germany from the country concerned could be credited and from which payment could be made for goods imported into that particular country from Germany, or any relative internal charges. This gave greater scope to bilateral trade

in such cases as the original foreign exporter was not obliged to become the ultimate importer.

By 1939 various amendments to and alterations in these different kinds of German " book " currency had taken place and certain refinements had been introduced, all of which may be summarized thus :—

1. Free Reichmark Accounts as in *(a)* above.

2. Preferential Blocked Marks representing a new type of account to cover (1), (2), (4) and (5) above.

3. Commercial Marks into which Preferential and Emigrant Block Marks became converted should they be transferred from the original to a new owner. Both Preferential and Commercial marks could be used for substantially the same purposes as the original Blocked Marks described in (1) earlier. Emigrant Blocked balances belonging to Jewish owners were not, however, transferable to any other owner, and so were incapable of being converted into Commercial marks. As speculators abroad were prepared to take a gamble in Commercial marks and purchase them for " free marks " at a heavy discount an active " black market " in this type of blocked currency sprang up greatly to the detriment of German credit and financial prestige in general.

4. Emigrant Blocked Marks as in (3) earlier.

5. " Old " balances as in (2) earlier.

6. Registered Marks as in *(b)* earlier.

7. Travel or tourist marks deriving from Registered marks passed to a Special Traveller's account as in *(c)* earlier.

8. " Haavra " marks, which were a type of Registered marks reserved exclusively for Jewish holders, and which could be used, if sold at a heavy discount abroad, to provide foreign exchange against which Jewish emigrants' capital in Germany would be released by the authorities there.

9. "Askimarks " which was the term applied to the former Foreigners Special Accounts for Payments in Germany (*see (d) earlier*) and which were available in the same way for the same purposes.

In addition to this galaxy of free and restricted types of currency the German system allowed for the allotment of a monthly quota of exchange to regular importers and firms outside Germany who regularly maintained accounts with German banks for trading purposes and included, of course, the licensing of all imports and exports. Clearing and similar agreements were entered into with a large number of countries, that with Great Britain providing that out of the proceeds of German exports to this country a sum of £4½ million should be earmarked for the payment by Germany for her imports from us. As payments under the "Standstill" Agreement and in redemption of other external indebtedness had also to be met out of export proceeds, it was clear that Germany's creditors had to accept goods from her to a value in excess of their own exports to her or forego any chance of ever getting back even a small percentage of their old debts.

The German system of restricting the use of various types of domestic funds or assets owned by foreigners has been dealt with at some length, since it appears to have been used as a model by many other countries and demonstrates so clearly the importance attached to the retention within the national economic system of all types of capital from long-term investment to actual liquid balances existing as at a certain date and of trying to create a new "free" currency out of normal commercial and financial transactions subsequent to that date. This again points the moral that money must first be used to further the exchange of goods and services and that in its purely financial aspect it is always liable to come under suspicion and to be locked up as having no visible means of support! Yugoslavia followed the German system in almost its entirety; Bulgaria, Poland, Rumania and Turkey created certain forms of blocked domestic currency and several South American countries adopted or adapted the same ideas.

A brief description of the various restricted types of sterling created in this country since the outbreak of war may be appropriate here. While Clearing arrangements canalize current payments between the two countries who are parties

to the agreement, they do not create a " restricted " form of currency. Any type of currency can only be regarded as restricted in use when internal laws or decrees set a limit to the purposes for which it may be used. The " Foreigners' Special Accounts for Payments in Germany " conception developed under the German system of exchange control was among the first principles to be adapted by the authorities here, and Sweden was the first country to which it was applied. Similar arrangements were subsequently entered into with several other countries, with a refinement in the case of the U.S.A. and Switzerland and a new development in the creation of accounts for individuals resident in the countries concerned which could be used for payments of a specified nature in countries included in the Sterling Area. By the end of 1940 the following types of restricted sterling accounts were in existence.[1]

(1) Special Sterling Accounts which resulted from bilateral Trade and Payments Agreements concluded between this country and each of the other countries concerned, *e.g.*, Sweden, Argentine, Brazil, Portugal, Uruguay, etc. These accounts became the only means by which current commercial or financial debts due by or to residents of the Sterling Area could be discharged.

If, for example, a Brazilian exporter sold goods to an English importer but shipped them on a British vessel under a c.i.f. contract, the English importer must pay for the goods by applying for and receiving permission to make a payment in sterling to the credit of a Brazilian Special Account (for the check imposed on such payments see the chapter on imports) ; on the other hand, the Brazilian exporter must discharge his debt in respect of the freight money due to the English shipowner by means of a sterling payment *from* a Brazilian Special Account. A vital underlying principle is disclosed. The English debtor or creditor pays or receives in his own currency—sterling. What exchange risk may exist is thrown on the creditor or debtor in the other country, since the rate

[1] The post-war position is described later.

of exchange between the foreign currency and sterling is fixed by the foreign authorities (the way in which this power may be used in place of an import tariff or export subsidy is discussed in subsequent chapters) and the English—or Sterling Area—trader need only quote or be quoted sterling prices on which the possibility of profit can be assessed. On the other hand, although the home authorities may be consulted by the foreign counterpart as to the rate of exchange to be applied to various types of transactions, they cannot, as a rule, insist on a rate being fixed which conforms to their own views, and it is quite possible for the authorities in the other country to fix discriminatory rates to apply to transactions which they wish either to encourage or to deter or even to render prohibitory. An essential feature of this system is that Special Sterling in use between the home country and any other is not available for use in respect of transactions with a third country, *e.g.*, if an Argentine intermediary sells Brazilian goods to this country the buyer must pay in Brazilian Special Sterling and the Argentinian must make his own arrangements to get the funds from Brazil to his own country. Similarly, a Portuguese who is owed money by a Brazilian who, in turn, is owed money by an English resident, cannot take advantage of the former method of offsetting of international debts under which London would have been asked to provide Portuguese instead of Brazilian currency against sterling, but the English debtor must discharge his debt by a sterling payment to a Brazilian Special Account and the Brazilian debtor must make his own arrangements for the discharge of his debt to Portugal without the intervention of London. In other words, payments between this country and certain others are definitely canalized and the offsetting of debts between three or more countries which was formerly carried out through the exchange markets of the world is no longer possible in the case of such countries with which this country has entered into agreements of this nature.

(2) Registered Sterling Accounts, which are a somewhat higher type of Special Sterling Accounts, set up under arrange-

ments entered into by this country only with Switzerland and the U.S.A.; our authorities undertake to convert balances on such accounts into the relative foreign currency, on application, at the official exchange rate then current. This is an excellent example of a controlled exchange rate but the yard-sticks by which such a rate should be measured and the flexibility which it should be given are discussed in another chapter. Swiss Registered Sterling cannot be transferred to a U.S. Registered account and vice-versa nor can either type be used to make payments to a third country with which other arrangements are in force, *e.g.*, Brazil or Portugal, so that such agreements are again bilateral and payments between the two countries are canalized.

(3) Central American Sterling Accounts are a type of Special Sterling Account applied to several countries as a group. Such sterling may be transferred without hindrance between account-holders resident in any of the countries of the group, *e.g.*, the Central American account of a bank or firm in Mexico may be debited with a payment which is to be credited to the Central American account of a bank, firm or individual resident in Nicaragua, but it is not available for making payments to Registered or Special Sterling Accounts. It can be used freely for payments within the Sterling Area, including payment for imports from that Area, and all payments by any resident of that Area to a resident in any one of the group of countries must be made by means of a credit to a Central American Account. Such an arrangement is not of course strictly bilateral but canalizes and restricts the making and receiving of payments between the parties. The rate of exchange between sterling and the currency of any country of the group is fixed by the authorities in the country concerned though representations might be made by our own authorities were the rate so fixed to be regarded here as economically unjustifiable.

(4) Sterling Area Accounts are accounts which may be opened by banks here in approved cases for firms or individuals resident outside the Sterling Area who have regular

commitments to meet within that Area and who therefore wish to be in a position to meet them without constant recourse to banks or exchange dealers for small transfers. The system applies only to certain countries, notably Switzerland (not the U.S.A.) and the Special Account Countries (but not Sweden) and such accounts are normally made use of by individuals who are in receipt of a sterling income, *e.g.*, from investments or under a trust, and who have personal liabilities to meet in sterling, *e.g.*, insurance premiums, school or college fees, subscriptions, etc., and who would otherwise have to lose the "exchange turn" or incur bank charges were they compelled to pass their sterling receipts and obtain their payments through ordinary market channels. Sterling on these accounts is not available to pay for imports into the account-holder's country from the Sterling Area nor is it eligible for transfer to another Sterling Area Account except one held by a resident of the same country as that of the transferor.

(5) "Old" Sterling Accounts are those already held by non-residents of the Sterling Area prior to the introduction of any arrangement between this country and the other country concerned for the canalization of payments as 1, 2 and 3 above. In several such arrangements provision has been made for the merging of "Old" sterling accounts of residents in the country concerned with the type of account newly appropriate to that country, *e.g.*, "old" U.S.A. sterling accounts have been transferred to or converted into U.S. Registered Accounts. In other cases, *e.g.*, Sweden and Switzerland, "old" sterling accounts cannot be so dealt with nor can they be used in payment for imports of goods; their use is restricted to financial payments within the Sterling Area or for transfers to any other "old" sterling account of a resident of the same country as that of the account-holder.

(6) Ordinary Sterling Accounts are those of residents of any country outside the Sterling Area with which no canalizing arrangements have been made. They can be used for making payments of any kind within the Area,

including payments for imports of goods, or for transfers to any other "Ordinary" Sterling Account, and so provide the type of sterling which was in general use before the outbreak of war except that it cannot be transferred to an owner in any country with which canalizing arrangements are in force, *e.g.*, sterling on a Persian ordinary account could not be transferred to a Swiss Registered Account, an Argentine Special Account or any Central American Account; moreover in some cases, *e.g.*, the Dutch West Indies and Free French Territory, a certain canalization has been deemed necessary and sterling owned by their residents, while available for all purposes within the Sterling Area, cannot be transferred to a resident of any other non-sterling Area country, *e.g.*, D.W.I. sterling could not be transferred to a Russian Account. Canada, as one of the British Commonwealth of Nations, although outside the Sterling Area, has a special type of sterling known as Canadian Authorized Sterling which, by permission of the Canadian authorities, may be used for transfers to Registered, Special, Central American or ordinary sterling accounts for all purposes as well being the complete medium of payment between Canada and the Sterling Area.

(7) "Frozen" sterling accounts, which may arise because the account-holder resided and is still in enemy-occupied territory, *e.g.*, the Baltic States or occupied China, or has escaped from such a country and reached Allied or neutral territory. In the former case the account can only be used for clearing up outstanding transactions to which the account-holder was a party and in the latter case certain remittances on a set scale may be made from the account to the owner in his country of refuge under certain conditions. Should he be granted an immigration visa into that or any other country or take up permanent residence within the Sterling Area, he can apply for his account to be redesignated as of his new country of residence and for his sterling balance to be released to him. If this is granted, his funds can then be transferred to him in the manner appropriate to his new country.

The " freezing " process can also be applied to the accounts of persons resident in a country which the authorities in the home country consider to be acting in a manner inimical to their interests. The balances on such accounts may consequently be made subject to a licence or to some form of official permission before withdrawals from or further credits to the account may be made, *e.g.*, the accounts in the United Kingdom of residents in Italy, following the application of " Sanctions " in October, 1935, when steps were taken to restrict the use which could be made by residents of Italy of their sterling balances, and the restrictions promulgated in the United States of America in 1942 and 1943 on the uses to which dollar balances in the ownership of residents of European countries might be put. In brief, a " Frozen " account is one which can be worked only under a mandate granted by the authority concerned.[1]

(8) " Blocked " Sterling Accounts are analogous to the blocked mark balances invented by Germany in 1933/4. In principle they cover all funds arising from pre-emergency capital investments or holdings in the home country and follow the axiom that if it was considered reasonable by a foreigner to deposit capital in any form in the country concerned prior to the development of any state of emergency in which that country might find itself, it was equally reasonable to require the detention of the funds within that country until such time as the state of emergency had been overcome and the country could afford freely to allow the transfer of foreign-owned domestic assets to any other country. This principle has been adopted by every country which has found itself compelled to adopt, in self-defence, an efficient system of exchange control and has much to recommend it. If the state of national emergency demands that home owners of capital abroad should place these overseas assets at the disposal of the State because the balance of payments in respect of the international exchange of goods and services is likely to be adverse to the country concerned, it is only logical

[1] See also p. 111.

for steps to be taken which will prevent foreigners from offering for sale on the world's exchange markets rights to the home currency which the foreigner was well content to retain until the state of emergency arose. The " blocking " principle can be applied to all forms of pre-emergency investment by foreigners whether in the form of securities, mortgages, business loans or advances, the finance of business by means of supplies of goods on indefinite credit, etc., as well as to credit accounts other than with banks, and even these latter became blocked under certain conditions under the decrees issued in Germany, Rumania, Yugoslavia and elsewhere.

In this country, current or deposit accounts of foreigners with bankers here became eventually " Old " or ordinary sterling accounts and were subject to no or only minor restrictions ; the logical step was also taken of according similar treatment to balances of this nature held for foreigners by stockbrokers, solicitors and commercial houses, or even in some cases, by private persons. The essential test would appear to be whether the funds concerned have been disposed of by the foreign owner in such a way that he can be assumed to have regarded them as invested indefinitely ; if so he must expect to be refused permission to withdraw those funds during a period of emergency for the country in which they comprise a capital investment. The proceeds of the realization of any foreign-owned assets which are so regarded are, therefore, directed to a " blocked " account in name of the foreign owner with a home bank and are only available for re-investment within the home country in specified forms.

Capital acquired by a foreigner by inheritance from the estate of a deceased home resident is similarly regarded as capital of which the transfer to a foreign country should not be permitted in times of great stress. Even sales of private property, personal effects, pictures, etc., can be regarded as a realization of locked-up capital and transfer of the proceeds abroad refused. In this country, however, with certain exceptions, *e.g.*, transfers to the Argentine, Canada, Newfoundland, or Switzerland, earlier restrictions have been

relaxed and inherited liquid funds or sales proceeds of personal property, as distinct from real estate held as an investment, may now be transferred to foreign owners while inherited securities under specific bequests may be transferred into the name of the foreign heir but without conveying the right of transfer of proceeds in the event of sale. Some relaxation in the blocking of certain types of foreign-owned capital has also been introduced here, *e.g.*, the proceeds of redemption of securities, but the basic principle of requiring the retention of previously-invested capital has been preserved.

As has already been said, there is a logical reason for refusing to allow foreign-owned invested capital (in no matter what shape) to be withdrawn from a country which is in the throes of a grave emergency, but it is evident that the essential right of mobility of capital is recognized, in this country at least, since it is possible for a foreigner, even under the conditions existing at the time of writing, to purchase securities through the Stock and Share Exchanges of this country with funds transferred here by a method appropriate to his country of residence, *e.g.*, in the case of a resident of Peru, by means of funds drawn from a Peruvian Special Account, and at the same time to obtain a licence (Licence M) which entitles him to sell the securities at any time and to have the sales proceeds re-transferred to a similar account. No doubt when the time of emergency is past and the capital structure of this country permits, a gradual relaxation in the existing restrictions on the transfer of pre-emergency capital investments to the country of origin will take place.

On the other hand and bearing in mind the pre-eminent place occupied by the pound sterling in the Exchange Markets of the world since, at least, Elizabethan times, it is regrettable that the stern exigencies of war demanded restrictions on the freedom of international transfers of our currency such as have been imposed by the bilateral Agreements which have created Registered, Special, Central American, Canadian Authorized, etc. sterling. Germany, under the Hitler-Schacht régime with her external obligations

which at that time were regarded as colossal, was able to permit the existence of a " free " reichsmark which could be transferred at will from the account of one foreign owner to another regardless of their respective countries of residence, but the mark, throughout history, has never enjoyed the status of an international currency such as that which has attached to the pound sterling or latterly to the American dollar. Moreover, the conditions attaching to the arrangements under which these various types of sterling have been set up must prevent, because of their bilateral nature, the attainment of a uniform value of sterling in terms of its international purchasing power since a surplus of sterling held temporarily by one foreign country cannot (except in the case of the Central American group) be offset against a possibly equal temporary shortage in another. This may be contrasted with transfers of sterling between countries included in the " sterling area ". In most cases permission to make such transfers is not required as no control is exercised except where the interests of a non-resident third party may be involved so that, for example, the Burmese owner of a sterling balance with a bank in this country can usually transfer it without permission to a similar account owned by a resident of Eire. On the other hand if a Brazilian importer of British goods wants to buy sterling against his own currency in order to pay the British exporter, while a Portuguese has sold sardines to this country and has received sterling in payment which he wishes to exchange for his own currency, there is no medium by which the need for and supply of sterling can be married up, even though there may exist at the same time a supply of escudos and a demand for cruzeiros which international exchange bankers would be quite prepared to equate against dealings in sterling. The very nature of the respective bilateral Agreements between this country and Brazil and Portugal makes it necessary for each of the foreign parties to deal in sterling against his own currency with his own local authorities at a rate of exchange arbitrarily fixed by them.[1]

[1] But see Chapter 10 for later developments.

The age-old principle of offsetting demand for against supply of any commodity (particularly such an international commodity as the pound sterling) is one which it would seem desirable to restore as rapidly as national and international interests will permit. Where and by whom a rate of exchange is fixed is of minor importance as whether cabbages are priced at 6d. each or 4d. a lb. The main thing is that a man who grows cabbages and needs a table, can sell his cabbages to any person who will give him sufficient of an acceptable medium of exchange to enable him to buy, amongst other things, a table; the pound sterling has been for centuries an internationally acceptable medium of exchange.

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CHAPTER 6

Control of imports—The licensing system—Allotments of exchange—Transhipment licences and trade between two other countries—Subsequent checks imposed—Control by varying exchange rates.

In what order of precedence should one place capital movements, imports, or exports when considering the external economic structure of a country? The writer has always argued that the seller (or exporter) holds pride of place, since a man who cannot dispose of the product of his industry is both a buyer without purchasing power and a potential investor deprived of the means of saving and subsequent lending. Yet, hitherto, the emphasis has been laid on over-production—not under-consumption; we have seen (with bewildered astonishment) cotton ploughed into the ground, maize burnt, coffee dumped into the sea, bonuses paid to pig farmers or potato growers *not* to breed pigs or produce potatoes and the like, what time this country has wilted under the burden of two and a half million unemployed and the "bread line" was a "head-line" in "God's own country"! However, the keen brains from Dr. Schacht onwards (or was he ante-dated by the Babylonians?) appear to regard capital

as the first thing to control and probably render immobile, with imports, which obviously deplete the external resources of a country, running a close second and the proceeds of exports as an "also ran". It is interesting to note, as an instance of the interlocking of exchange and trade control, that under the Schacht régime the value of German exports rose by 21 per cent. between 1933 and 1937, while the internal price level rose by 13 per cent. only; on the other hand, the value of German imports in 1937 was only 29 per cent. of the 1933 value. In this country control of the use of foreign exchange resources was introduced simultaneously with restrictions on imports on the outbreak of war, which seems to imply an equality of importance to financial (including mainly capital payments) and commercial settlements of debts. Control of exports, and then only to a limited degree, was instituted six months later; meanwhile exporters (the potential buyers or providers of purchasing power) were free to sell where and how they chose. It is interesting to read a paragraph in an excellent little brochure issued by the London Office of the Swiss Bank Corporation (7th edition, May, 1939) on "Foreign Exchange Restrictions" under the heading of Estonia. This tiny republic promulgated decrees in December, 1931, of which the brochure thus summarizes certain sections: "Foreign Exchange is allotted on maturity of bills drawn on Estonian importers when they are in respect of imports approved by the Foreign Exchange Control and are stamped accordingly by the authorities on presentation. *On the whole settlement for goods originating from countries to which Estonia ships more goods than she receives is effected without difficulties.*" One is reminded of the biblical saw "out of the mouths of babes and sucklings, etc."

But following the later trend of thought, this chapter places imports as ranking next to or equal with financial and capital obligations as matters over which a comprehensive system of exchange control must exercise supervision. The earlier system of tariffs was designed more to produce revenue or to protect home industries than consciously to control the

volume and origin of imports which necessarily is the object of a system of exchange control. During a state of grave emergency a nation must have regard to what and whence it can afford to import to meet its essential needs and considerations of revenue and " protection " must recede into the background. The only effective method of controlling imports is by a system of licensing under which both the volume and origin of imports can be rationed. Such a system can be (and has been in this country) closely linked up with any internal system of rationing and it also admits of a rationing of its own since importers can be allotted a " quota " based on previous turnover so that any given industry or trade can be kept alive while at the same time the calls on the country's external resources are reduced to a minimum.

While these principles appear to command general acceptance the actual mechanism employed has varied. Payment for an import involves, of course, a payment in foreign exchange —whether in terms of a foreign currency or of some restricted form of the home currency, *e.g.*, a payment in sterling to an Argentine Special Sterling Account is in effect a payment in foreign exchange since sooner or later the sterling which has passed to Argentine ownership must be exchanged for Argentine pesos and the loss of exchange absorbed by this country. The most crude method of control is that by which no actual import licences are issued but the desirability of the import is examined only when the importer makes application for the necessary foreign exchange to be sold to him. For example, in Hungary an importer could only make the application for an allotment of exchange when he was in a position to produce a bill of lading or waybill, customs receipt, etc., all of which he could obtain only when the relative goods had arrived in Hungary from abroad. The period of delay between application and allotment was determined by the economic importance of the goods in question ! The fate of the over-trusting foreigner whose goods were deemed to be imports not of economic importance is evident—and yet Hungary complained that she was driven

into the arms of the Axis because she was cold-shouldered by the other trading nations.

From this extreme one can go to another which is a system requiring both an import licence and an exchange permit. While such a system should, of course, be absolutely water-tight it is open to abuse and is somewhat involved in its working. In this country at the present time, for instance, an importer wishing to buy goods from Brazil for which the seller insists that a documentary credit shall be opened in his favour, must first complete a form of application for a licence to import the goods at all. If this is granted he must then complete a form of application for permission to open a credit in favour of the seller and having secured this he must then complete and obtain approval to yet another form each time a payment to a foreign account is made under the credit.[1] Further, on arrival of the goods he must complete an additional copy of the usual Customs Entry Form which must be stamped by the Customs authorities and is then used in substantiation of the payments which have been made abroad. All these formalities may be irksome to the trader and it should be an axiom that the mechanism of an exchange control should be so designed as to ensure willing co-operation by and lack of friction with the people to whom it is applied. It is the fact that under this country's system the possession of a valid Import Licence appears to convey *ipso facto* the right to effect any necessary payment of funds to a foreign account, but in other countries, *e.g.*, Bulgaria in 1931, even though a quota system for imports was in force and an import licence had to be obtained before the goods could be cleared through Customs, the eventual application for a permit to purchase the foreign exchange needed to effect payment could be (and often was) refused by the National Bank of Bulgaria without any reason being given. In such circumstances it is the foreign exporter who suffers in that he is

[1] Payment for imports is normally allowed only to and in the manner appropriate to the country of origin of the goods, regardless of the country from which they were purchased or consigned.

either not paid at all or must accept payment in the importer's currency which is probably "blocked" or at best can only be used for the purchase of that country's goods which may or may not be saleable elsewhere and even then possibly only at a loss.

The quota system is another method of minimizing the drain on foreign exchange resources which is caused by imports from abroad. Many countries for some years before the war had adopted this basic principle for the control of exchange even where other more modern refinements had been introduced. Bulgaria, Germany, Greece and Chile, amongst others, adopted this system either with or without a complementary licensing system. Such quotas are usually granted on a percentage basis of the importer's business in the relative class of goods with the foreign country in question over a preceding period which is usually a year but may be only six months, so that opportunity can be taken frequently to reduce the incoming volume of certain types of commodities. Thus an importer who had purchased from a foreign country 100 tons of a not very essential commodity during the first basic period might be allotted a 70 per cent. quota for the first quota period which then gives him a basic quantity of 70 tons. If for the second quota period he is allotted only a 50 per cent. quota he can only import 35 tons during that period and so on. Latterly this system has been accompanied by an internal rationing of residents for quota commodities, and both methods have been applied to essential as well as to less essential or luxury goods. The complexity of the problem is apparent when it is appreciated that the authorities must consider :—

(*a*) how much of the exporting country's exchange can be spared for imports of the nature in question ;

(*b*) what quantity of such commodity is essential for national needs, *e.g.*, war production ;

(*c*) what quantity is essential for meeting the minimum requirements of the home market ; and

(*d*) what quantity is essential to maintain a certain export trade in that commodity or in a product of which it forms a part.

If we apply these considerations to such commodities as rubber, cotton, tobacco, wool, or meat the vastness of the field to be covered and the need for some form of curbing domestic consumption, *e.g.*, a permit to buy motor tyres or a limit on the quantity of meat to be supplied weekly to any one individual, becomes evident. Add to these factors the shipping space required to import these primary products and, in time of war, the provision of sea and air protection for the convoys of merchant vessels in which they must be carried. The marvel is not that the task was not done well (which it has been), but that it was ever done at all. And dare we anticipate that in a matter of months after the conclusion of hostilities, restrictions on the volume of imports and on selling prices can be removed in this or any other of the countries now imposing such controls or that their imposition in any of the liberated countries will be unnecessary? Over a period of years the answer is emphatically " no " from every association of employers or employed, leading industrialists, thoughtful people, or politicians. We must, therefore, be prepared for a continuance of a system of licensing of imports probably on a quota basis and accompanied by some form of domestic rationing by coupons, points or purchasing value over a period. As was suggested in a previous paragraph, the issue of an import licence should carry with it automatically the right to the acquisition of the necessary foreign exchange or other authorized means of paying for the import so as to reduce to a minimum the formalities and clerical labour imposed upon traders and their bankers.

By tradition and practice this country holds the premier place for entrepreneurs in international trade. (A little book entitled *England's Service*, written under the pseudonym of " Sarpedon " and published by Macmillans, is indeed well worth reading.) With the canalization of payments under a variety of bilateral agreements, to which reference has been made in an earlier chapter, this type of trade has been rendered difficult. For example, a London merchant may arrange to buy sardines in Portugal and sell them to Sweden.

He is not, however, permitted to pay the Portuguese seller by a transfer of sterling to a Portuguese Special Account and to receive payment from the Swedish buyer by means of a transfer of sterling from a Swedish Special Account even though this means merely the passing of cheques to and from London banks and even if the profit is one hundred per cent. or more. Under present conditions he must arrange for the whole transaction to be carried through in terms of a currency other than sterling whether it be Swedish kronor, Portuguese escudos, American dollars or Swiss francs. If the goods are coming from the selling country to this country *en route* to the buying country, the merchant must obtain a "transhipment" licence if they are not to be taken out of bond, but if they must be cleared from Customs in order to be repacked, relabelled or processed in any way he must obtain a "re-export" licence in order that the goods shall be admitted into this country. In either case the relative licence is granted only on condition that the foreign seller is paid and the foreign buyer pays in some currency other than sterling.

It is obviously necessary to impose a check on transfers of funds abroad which are said to be in payment for imports under a system which requires separate applications to different authorities for permission to import goods and for permission to pay for them. In this country this result is achieved by requiring the importer :—

(*a*) to quote the number of his import licence on his application, completed in duplicate, for permission to transfer funds abroad and to exhibit the licence to the bank through which he is applying so as to prove that he is no liar ;

(*b*) to complete an extra copy of the form needed to enter the goods through Customs ; this is stamped by the Customs Official and endorsed by him with any restrictive or qualifying clause appearing on the import licence which must be surrendered to Customs by the importer when making such inward clearance of the goods ;

(*c*) in substitution for (*a*) to submit the shipper's invoice

and the copy of the Customs entry officially completed as in (*b*) when making application for the transfer of funds abroad in payment for the goods, which still must be in duplicate;

(*d*) where (*a*) is followed by (*b*), to attach to the duplicate of his payment application form the Exchange Control copy of the Customs Entry form together with certified copies of the shipper's invoices, or of the Account Sales in the case of consignment goods, and to lodge these documents with his bankers who must, in turn, lodge them with the Exchange Control authorities for transmission to the relative department of the Customs.

In either (*a*) and (*b*) or in (*c*) the original of the payment application form will be retained by the banker effecting the transfer and eventually lodged as an "executed" form with the Exchange Control authorities by whom it will be sent to the Exchange Control Branch (Imports) of the Customs. This Branch records and files all these forms pending the eventual receipt of the duplicate form documented as in (*d*) above. The Customs are, therefore, in a position to check the volume of goods actually imported as against the quantity authorized by the import licence (which is also forwarded to the Branch concerned by the local officer at the port of entry where it must be surrendered to him by the importer) and the value of the goods as estimated by them against the amount actually transferred abroad, as well as seeing that this agrees with the amount of the shipper's invoices or the Account Sales. By a system of diarizing, Customs can also check that goods to an appropriate value eventually arrive in this country against every transfer of funds abroad which has been approved as being in payment of an import since all such "executed" applications come into their hands. If such an application remains undocumented as described above for more than a few months the applicant is called upon for an explanation and would be liable to prosecution if deliberate evasion of the law could be proved. The Customs, therefore, are entirely responsible for most of the formalities and for the *ex post facto* check on the actual import and value of goods.

Finally, a method of control of imports which unfortunately is open to abuse and graft, but which has never been and is not likely to be adopted by this country or by any Dominion, is that by which the authorities apply varying rates of exchange when selling foreign currency in payment for imports according to their estimate of the importance of the goods to the national economy. Exchange for payment for goods of a really essential nature is provided at a rate more favourable to the importer than for goods of a less essential nature and the rate offered becomes steadily more unfavourable to the importer with the lessening importance to the country of the proposed import. Under this method it is possible to foster a home industry by making the landed cost of foreign goods of a like nature higher than the price of the home-produced article. For example, if the purchasing power parity between Sweden and Switzerland were Sw.Kr. 100 equal Sw.Frs. 100 and Sweden was in course of developing a watch-making industry but could only produce a watch for 100 kronor while the landed cost of a Swiss watch was only 90 kronor, the Swedish authorities could list Swiss watches as an unessential import entitled to exchange at the rate of only 75 Swiss francs per 100 kronor. This would mean that the landed cost of a Swiss watch would go up to nearly 117 kronor and thus place such goods at a disadvantage against the home-produced article costing only 100 kronor.

An actual instance of the use of this method took place in the Argentine. From 1934 onwards a strict control of the major exchanges had been in force in that country coupled with a less strict system of import licensing. In 1938 the official buying rate for sterling was still 15 pesos per £, having remained unchanged since the spring of 1934, and the selling rate was about 6½ per cent higher at 16 pesos per £, but owing to the Argentine Government having fixed an internal price for wheat in order to placate home producers, which subsequently proved to be above world-price and so involved the government in a heavy loss, it was decided to endeavour to recoup part of this loss out of additional

exchange control profits and still further to restrict imports. The selling rate for sterling was, therefore, raised to 17 pesos per £ and made applicable only to payments for goods for which "priority" import permits had been granted, and these were issued entirely at the discretion of the authorities. All other payments requiring to be made in sterling were subject to a surcharge of 20 per cent. or the sterling could be purchased in the free market which then stood at about 19.50 pesos per £. This drastic measure soon produced results—principally in a large reduction in the volume of imports and vociferous protests by local merchants —and in 1939 the surcharge was reduced to 10 per cent., but the system of "priority" licences was retained. The objections to this system are, of course, that it acts as a tariff without the amelioration of the "most favoured nation" clause and, as in the instance quoted, places what is in effect a tax only on particular classes of trade at the fancy of the government whose revenues the tax is designed to augment. The less desirable aspects of possible back-stair influence need not be enlarged upon, and the system would appear to have far less to recommend it than the "quota" licensing system or even a straightforward protective tariff.

Undoubtedly the most satisfactory method is that which requires an application for permission to import commodities of any kind but under which the granting of an import licence also authorizes the holder to effect the necessary eventual transfer of funds abroad without further application or formality. The authority to import may bear a variety of titles, *e.g.*, since 1938 in Colombia and Ecuador a prospective importer must first apply for a "permit to import" which, if granted, entitles him to apply in due course to an exchange bank for an allotment of the necessary foreign currency on production of the permit and evidence that the relative goods were imported within the period of its validity; or in the Argentine, since December 1938, where the importer must obtain a "permiso previo" (prior exchange permit), which allows him not only to import the specified merchandise

but to apply to the Exchange Office to obtain the requisite exchange. This obviously reduces to a minimum the essential formalities necessary under any efficient form of exchange control (which, willy-nilly, must impose certain restraints and obligations on traders) and at the same time allows the authorities to exercise discrimination between essential and non-essential imports.

A marked feature of import control is the degree of attention paid to essential and non-essential goods. Not only have such imports been controlled by the granting of import licences, as in this country, and/or exchange permits, but they have also been encouraged or hindered, respectively by the application of varying exchange rates or, and more properly, by a system of quota allotments. For example, in 1938, in Czechoslovakia, applications for import licences (which, if granted, carried with them almost the certainty that the National Bank would supply the requisite foreign exchange in due course) were judged strictly on whether the relative goods were essential raw materials or other commodities of vital importance to the national economy ; merchandise of a less essential or luxury character stood a poor chance of being licensed in full or even at all. But the Czechs of late years have been as realistic as the Russians. Similarly, Greece in 1932 introduced an import licensing system based on quotas for less essential goods, but providing a " free " licence for a number of essential products.

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CHAPTER 7

Control of exports—The licensing system—Measures to ensure the return remittance of the export proceeds—Use of the " coupon " system—Application of varying exchange rates.

In the case of all countries the proceeds of the sale of exports to other countries constitute the chief means of replenishing and maintaining their external resources. Many national examples exist of the truth of the maxim that a seller deprived

of a market is a buyer robbed of his purchasing power, and if, for instance, world conditions prevent Brazilian coffee growers from disposing of the whole of their annual crop at reasonable prices the power of Brazil as a world unit to acquire the products of other countries is correspondingly reduced. Following this to a logical conclusion, the potential sellers elsewhere whose market is thus contracted must in turn contract their own purchases abroad and world trade would continue to dwindle with disastrous results in the shape of unemployment, lowered standards of living and wastage of natural resources.

It is argued that there can be no such thing as world over-production until the last Hottentot is driving his Rolls Royce and there certainly seems something wrong with methods of distribution and the provision of purchasing power when wheat could be burnt, cotton ploughed into the ground and coffee dumped into the sea at a time when there were many millions of unemployed in the "civilized" world. The variety and diversity of tastes and habits developed under world social and economic evolution demand the freest possible international exchange of goods and services for their satisfaction and further development, and some broad conscious planning to this end seems not only likely but essential if social progress is to continue.

The maintenance and extension of export markets is, therefore, of the first importance under ordinary conditions, and in any state of national emergency export trade requires to be considered from at least three aspects, viz. :—

(1) What steps are necessary to ensure that the full proceeds of exports are made available for national purposes?

(2) Is the maximum of trade being directed towards those countries whose currencies are of the greatest use to the nation?

(3) To what extent can the materials and labour necessary to preserve a certain volume of exports be spared from other priority requirements?

The question of available shipping space and, in time of war, escort facilities must also be answered and the possibility of substituting new lines of goods for others which can no longer be spared or manufactured must be considered.

The second and third points can be covered by a system of export licensing. The government department concerned will be kept constantly advised by other departments of the countries to which exports are imperative and of stocks available for export. The latter is an extremely complicated question as the authorities must calculate how much of the commodity must be produced for national, *e.g.*, war needs, how much for essential home market requirements, how much foreign raw material or components will need to be imported for this minimum output and from where (whether from a country to which much is already owed or from one with which the balance of payments is more in equilibrium) and how it will be carried and what additional materials and labour will be needed to secure an exportable surplus. On these data the licensing authority can be advised of the estimated quantities of all kinds of commodities likely to be available for export over an ensuing period and that authority can then grant or scale down (usually on a quota basis) applications for the relative export licences. Under this method it is, of course, possible to grant licences in full for exports to the "first preference" countries if supplies are sufficient, and to scale down drastically proposed exports to less important buyers. Exporters can also be advised through their trade groups to endeavour to expand their exports to the "first preference" countries and to contract them elsewhere, but this policy if pursued too far may result in the permanent loss of markets which would form a useful outlet in more normal times. The whole process, of course, involves a large measure of State control of and interference with the enterprise of the individual trader, and for this reason is regarded with disfavour and as a purely emergency measure which should be removed or at least materially relaxed as soon as possible after the passing of the emergency.

The first point, which not only covers the need for directing into the hands of the State a very appreciable volume of external resources, but also the prevention of exports of capital in the shape of goods, is capable of various methods of solution. Any form of Clearing Agreement, of course, ensures that exports by one country to the other are paid for in full in the currency of the importing country by a credit to the official account of the exporting country so that the State becomes possessed of the full export proceeds in the foreign currency but pays the exporter in domestic currency and thus increases its external resources. Many South American countries have for some years insisted by force of law that payment for exports to certain other countries must be obtained through bills drawn on the foreign importer in the currency of the importing country which must be sold to the home Central Bank or any other bank acting as agent for the State. The bills are, of course, purchased from the exporter against payment in domestic currency and are collected abroad on State account so that by this method again the entire proceeds in foreign exchange of such exports can be brought under the control of the State. Further, under this system the compulsory surrender of export proceeds can be graded according to variations in the national need for certain foreign currencies from time to time and can be decreed to apply only to selected commodities, *e.g.*, in 1938 Venezuela issued a decree that only the foreign exchange proceeds of exports of agricultural produce and of oil need be surrendered to the exchange control authorities. The grading of the proportion of exchange to be surrendered by exporters may be done by fixing arbitrarily a percentage of the full shipping invoice value which must be sold to the State, as was decreed by Brazil in April, 1939, when the law of December, 1937, requiring all export bills to be sold in full to the Banco de Brazil was amended to permit certain authorized banks to deal in foreign exchange provided that 30 per cent. of the exchange resulting from the purchase of export bills was sold to the Banco de Brazil at the official

rate of exchange. This meant that an exporter could dispose of 70 per cent. of his shipping invoice value at the "free" market rate of exchange which invariably gave him a better yield in terms of his own currency than the official rate.

Another method of grading is for an exporter to be required to surrender only the equivalent in foreign exchange of his actual production costs leaving him free to deal in the open market with such part of his shipping invoice as covers packing, freight, insurance, profit, etc. Chile applied this method to her exports of copper in order not to penalize producers too heavily and possibly prevent them from competing in the world's markets which might have happened had the official rate of exchange (which of course overvalued the Chilian peso) been forcibly applied to the full amount of their shipping invoices. For example, if the official rate were 15 pesos to the £ and the "free" market rate were 18, an exporter with a c.i.f. invoice for £1,000 would receive 15,000 pesos at the official rate ; but if one-half of his invoice amount was in respect of freight and insurance which he himself would have to pay in sterling to United Kingdom shipping and insurance companies and which he would have to repurchase in the "free" market at 18 pesos per £, it would cost him 9,000 pesos as against the 7,500 he had received for this part of his invoice. He would necessarily have to raise his c.i.f. price to cover this loss and with a competitive commodity this might cost him his market. By requiring him, however, only to surrender the foreign exchange proceeds of his actual production costs, *i.e.*, £500 and allowing him to deal in the "free" market in the other £500 he merely suffers the loss of the "dealer's turn" between buying and selling prices, which is a matter of a few centavos only, and might even be able to arrange with his own banker to offset the receipts and payments in sterling (apart from the sum compulsorily surrendered) for a small charge.

In this country, control of exports has been imposed by degrees. It was first applied only to a few countries and to very few commodities and was accomplished by means of a

licensing system and a subsequent check through an exchange control process. The control has been gradually extended and now covers practically all commodities and most of the countries of the world *outside the Sterling Area*. An exporter is at present required first to obtain an export licence [1] without which he cannot obtain an allotment of shipping space from the Ministry of War Transport to whom he must make the necessary application.[2] Next, at the time of pre-entry of the goods through Customs, *i.e.*, when they are being carted on to the dock or wharf for shipment or handed to a post office if they are being forwarded by mail, he must complete a form C.D.3 which embodies not only all details of the goods, their value, the consignee, etc., but also includes a statement as to the method by which he will receive payment for the goods. Unless this last is a method appropriate to the country to which the goods are consigned, *e.g.*, dollars or U.S. Registered Sterling from America, Brazilian Special Sterling from Brazil, Central American Sterling from Mexico, etc., the Customs will not accept the entry. If it is in order, however, Customs will retain pages 1 and 2 of the form and hand back pages 3 and 4 to the exporter for eventual completion which takes place by the certification by a bank that the gross proceeds (or possibly a net amount since certain deductions, *e.g.*, for agent's commission, are permissible if a statement reconciling the eventual net amount with the original declared value is submitted) have in fact been received by an appropriate method. This certification is given by the bank collecting the proceeds on behalf of the exporter or to whom he has instructed the proceeds to be sent or credited. This completed second part of the form must then be lodged with the Exchange Control authorities by whom it is examined and, if found in order, sent to the Branch of Customs concerned to be married up and checked with the first part.

In cases where the exporter does not expect to receive payment for the goods, *e.g.*, samples or a small gift, he must

[1] Now practically abolished.
[2] Now the Ministry of Transport.

state this on his form C.D.3 and arrange with his bankers for the form to be submitted to the Exchange Control authorities to be franked " shipment without payment " before he sends forward the goods for shipment or posting, when he must produce the " franked " form. Where he has undertaken that payment will be received by an approved method he is usually allowed a period of six months for the eventual remittance of proceeds and if they have not come to hand within that time he must apply to Customs for an extension of time with reasons for making the request. If this is not done, Customs will commence investigations into the cause of the delay in remittance and should they be able to prove attempted evasion by the exporter he is liable to prosecution.

An additional restraint on the volume, though not the direction, of exports has been introduced in this country by the application of the " coupon " system to certain types of goods. We are all painfully aware at the present time that our ability to purchase clothing and clothing materials depends more upon our stock of coupons than on our available cash. Most people also know of the system under which the coupons which they surrender to a retailer are banked by him and drawn on to cover the coupon value of further supplies which he receives from wholesalers. These latter must in turn pay coupons as well as cash to the manufacturers who must surrender them for further supplies of raw materials.

This method of rationing has been applied to the export of similar commodities in conjunction with and as part of the " quota " system of licensing. An exporter is granted a quota percentage of the value of his exports to given countries during a basic period. He can then apply to the Board of Trade for the coupons which he will need for the purchase of this quota (in the case of manufacturers who are also exporters it will be for the purchase of the necessary raw material or partly-finished product) for which he will be called upon to account in due course. The quota percentage is liable to revision at stated intervals. Where a merchant has goods in stock which he is prepared to export without replacing

them (either to try to maintain a foreign connection which he could not supply out of his quota or to obtain a better price abroad), he may be granted an export licence which does not carry a right to coupons but the granting of such a licence will be dependent on the current relation between demand and supply in the home market and the merchant's stock will be depleted indefinitely to the extent of the quantity exported. The interlocking of home rationing of certain goods by means of the coupon system and the application of that system to the export abroad of similar goods is thus achieved.

The export of selected commodities can also be encouraged or hindered by the application of special rates of exchange to the eventual export proceeds though such a method has not been adopted by this country nor by any other " Sterling Area " country. For example, if Chilian natural nitrate was being ousted from the British market by German synthetic nitrate it would be quite possible for the Chilian authorities to decree that export bills in sterling drawn against nitrate shipments should be purchased at 17 pesos per £ as against the official market rate of, say, 15 pesos per £. This would mean that the nitrate exporters could afford to cut their selling price in sterling by 12 per cent. and still make practically the same internal rate of profit since a shipment valued at £100 on a rate of 15 to yield 1,500 pesos could be valued at only £88 on a rate of 17 and would still yield 1,496 pesos. The converse also holds good and exports of a commodity which the authorities desire should be retained in the country or only sold to certain quarters can be discouraged or even stopped altogether by an official decree that the relative export bills will only be purchased at a rate less favourable than the official market rate, *e.g.*, with a market rate of 15, an export rate of 13, 12, or even 10 could be officially applied to export bills drawn on certain countries in respect of selected commodities so that the exporter would be forced to quote prices abroad which would be uncompetitive to a degree dependent upon the rate fixed.

Such manœuvres are, however, not properly attributable

to exchange control but are in effect subsidies on the one hand and taxes on the other applied to exports of an arbitrarily chosen commodity or group of commodities.

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CHAPTER 8

Ancillary controls—Control of overseas transport—Economic warfare —Enemy accounts in time of war—The Censorship—Restrictions on travel and expenditure abroad—Restrictions on the import and export of banknotes and coin—Immigration and Emigration Officers—The quota system for immigrants.

ANY comprehensive system of exchange control, particularly in time of war, requires the use of a number of ancillary controls as well as the closest possible linking up with other major controls. Even in circumstances other than war, necessitating the imposition of extensive measures of exchange control, the close supervision of import and export trade which is thereby entailed calls for measures of co-ordination in the use of such shipping space as is available to the country concerned, while, in time of war, rail and road internal transport will also need to come under the control of some central authority so that it may be used to the best national advantage. In this country at present[1] these functions are performed by the Ministry of War Transport (formerly the Ministry of Shipping), and the operations of this Ministry in regard to overseas transport are intimately related to certain aspects of the control of the exchanges. All available freight space is allocated by the Ministry for both imports and exports on a priority basis for which wartime needs of movements of men and materials must be paramount. Close attention must also be paid to the vital necessity of keeping a minimum amount of export trade in being, particularly to those countries whose own exports we must have. At the same time the problem is further complicated by the

[1] 1945. No longer the case.

variety of vessels in use. A refrigerator ship bringing meat from the Argentine could not be used to take back a cargo of textiles or pottery, and the arranging of itineraries for vessels so as to ensure that they seldom, if ever, have to sail in ballast is a highly technical business. The seasonal nature of the exports of certain countries must also be taken into consideration and arrangements made with and export licences issued to groups of home exporters so that their shipments to such countries shall coincide with the departure of vessels outward bound to pick up such seasonal exports. This Ministry must also work hand in hand with the Admiralty and Air Ministry so that adequate protection for convoys is provided.

In time of war it is of the first importance if possible to prevent the enemy from receiving supplies from his allies or from benevolent or avaricious neutrals. This is done mainly by blockade, but in some cases arrangements may be made (known as "pre-emptive buying") for supplies in neutral countries to be purchased in bulk, even if they are not actually required by the belligerent concerned, so as to eliminate the possibility of their being acquired by the enemy where he is believed to be in need of them. A special government department is usually created to carry out these and other even more secret duties; here in the First World War a Ministry of Blockade was formed, but in the Second it was known as the Ministry of Economic Warfare. It impinged on exchange control in many ways which cannot for the present be specified, but it is evident that "pre-emptive buying" had to be conducted in concert with other authorities. Questions arose as to the comparative values of certain supplies to ourselves and to the enemy and whether the value to us of the exchange which would be needed to acquire the goods in a neutral country was greater or less than the probable need of the goods by the enemy. A large stock of chrome, for example, might be of little use to us but greatly wanted by the enemy and even though we might be short of the exchange of the country concerned it might be deemed desirable to

overlook this factor and to acquire the chrome at all costs to prevent it passing into enemy hands. Again, the examination of cargoes in the course of a blockade, and the diversion and seizure of those regarded as contraband, also raised points affecting the Exchange Control as a seized cargo or its sales proceeds might be released by the Admiralty Marshal to a non-enemy owner on proof of good faith and in such case the goods would become an ordinary import for which payment had to be made to the country of origin. Incidentally, this Ministry was responsible for the issue of certificates of exemption from search or seizure of goods. These were known as "navicerts," and were issued to the masters of vessels when the ship's manifest for any voyage had been examined and approved by local officers acting for the Ministry or to individual shippers in certain circumstances and in respect of their portion of a whole cargo. The production of a "navicert" to any Naval Officer on blockade duties ensured a safe passing through the blockade.

Another war-time task which cannot be finished until years after the conclusion of hostilities is the registration of debts due between enemy and home residents. In this country this is the duty of the Custodian of Enemy Property in association with the Administration of Enemy Property Department of the Board of Trade. All debts due by residents to enemy nationals must be paid to the Custodian or held for his account, and he must be notified of all debts due by enemies to residents. Any other assets, *e.g.*, securities or property, held by residents for enemy residents or *vice versa* must be declared to the Custodian, and his instructions followed as to any action to be taken in respect of such assets. The Exchange Control authorities are necessarily concerned with any of such debts or assets as are in the form of gold, specified currencies, or restricted or vested securities, and the eventual legal position of the Custodian should he surrender to the Exchange Control any property of a foreign owner must be considered as against the immediate advantage to the country of acquiring any of such assets. The former

Trading with the Enemy Department was also responsible for supervising any contacts between residents and enemy residents through neutrals, for the compiling, in association with the Ministry of Economic Warfare, of a " black list " of firms and persons in allied or neutral countries whose associations with enemies were so close as to make it necessary to ostracize them as far as we (and probably our allies) were concerned and for many other duties of a like nature. The Department also had to work in closely with the Exchange Control in regard to transfers of funds to persons formerly resident in enemy territory, but who had escaped and taken up residence elsewhere and needed money for their maintenance.

Any control of all or part of a country's external economy required the imposition of a censorship of correspondence and cables going out of or coming into the country. However distasteful this principle was to our national character we had to accept it as one of the trials of war-time. The need for such supervision of private affairs is shown by the number of successful prosecutions of residents of this country for offences against or evasions of the Defence Regulations in general, and the Defence (Finance) Regulations in particular; most of these actions could not have been brought without the information obtained from a scrutiny of missives addressed by or to the firms or individuals concerned. A casual reference in a letter or cable would lead to such full enquiry as to disclose gold or exchange held abroad (or even at home in the case of the former), the ownership of undeclared restricted securities or of a majority interest in a foreign concern or of other infringements of the Regulations. The Censorship Department necessarily was in close touch with other " security " departments, and with the Trade and Exchange Control authorities.

Official conservation of external resources extends to restriction on travel and on the expenditure of funds abroad. For some time before the war many Central European countries, while allowing their nationals reasonably free facilities to visit other countries, drastically limited the amount

of funds which they could take with them or have remitted to them while in such other countries. The restrictions of this nature which have been imposed in this country consist of requiring any intending traveller to obtain from the Passport and Permit Office an Exit Permit authorizing him to leave this country for a stated period and for a specified purpose.[1] A valid passport must be held and an application for an Exit Permit is considered in the light of the benefit which may accrue to the country as a result of the proposed journey. A visa entitling the traveller to enter the country to be visited cannot be obtained until a valid passport and Exit Permit can be exhibited to the foreign authority concerned. Exit Permits for travel for purely private reasons are granted only exceptionally and probably where the traveller will not require the remittance of funds from this country for his maintenance. Where an Exit Permit is granted for a business, professional or political journey it almost automatically carries with it the right on the part of the holder to obtain from the Exchange Control authorities permission to take with him or to have transferred to him abroad a sum sufficient to cover reasonable expenses of maintenance and travelling. These restrictions ensure both that journeys are necessary and that too much of our external resources is not used on them.

Control of the exchanges includes control of the import and export of the country's currency in the form of notes and coin. Control of the former is necessary because the state of emergency which led to the imposition of Exchange Control invariably causes a fall in the external value of such of the country's currency as is held abroad in cash and it is undesirable that money standing at a discount as against the official exchange rate should be allowed into the country to compete as a purchasing agent with money purchased at the official rate, while control of the latter is essential to prevent exports of capital in the form of cash. Even in 1938 certain countries had imposed limits on the amount of their currency in cash which could be imported or exported without

[1] Since abolished.

special authority having been obtained. For example, Czechoslovakia would only allow the free entry of Kc.300 in notes and coin and the free exit of Kc.300 to adjacent countries and Kc.500 to others ; Germany allowed only RM.30 and RM.10 respectively, and then only in silver coin ; Italy allowed Lire 300 in notes and 50 in coin and Lire 50 respectively. These countries also limited the expenditure of travellers within their borders to Kc.2,500 per week, Travel Marks 50 per day and Lire 300 per day respectively unless special authority for a higher rate of expenditure had been obtained beforehand from the Exchange Control concerned.

In the case of this country, the free import or export of bank notes, either sent through the post or taken on the person, was first allowed up to £10 per letter or per person, but for a time this limit was increased to £20. Early in 1948, however, this limit was reduced to £5 only, and this amount in sterling notes may be taken on the person by anyone leaving this country, but an official warning is issued that this allowance is for use only on board British ships or aircraft and to meet travelling expenses on return to this country. Notes carried in this way may not be exchanged or used outside the Scheduled Territories (Sterling Area). It should be noted that these restrictions do not apply to Eire. No official restriction appears to have been placed on the import or export of United Kingdom coins but, administratively, the Customs Officers at points of departure would retain any loose change in excess of about £2. It is the duty of Customs Officers, in addition to examining passports, visas and Entry and Exit permits, to require from travellers a declaration of all dutiable goods or articles carried, and of the amount of money which they have with them. Any sterling notes in excess of £5 found in the possession of any person leaving or entering this country (except travellers to or from Eire) are liable to confiscation, and the Customs Officers have powers of search at their discretion. . In the case of a traveller who is entering this country on a short visit, and has come provided with funds, the Customs Officer will, on request, furnish him with a Certificate, showing in detail the

funds carried, e.g. £5 sterling notes, £50 sterling travellers' cheques, $65 in U.S. notes, and Fcs.10,000 in French notes. This Certificate will enable the traveller to obtain official permission for the re-export of up to the stated amount of foreign currencies at any time within the ensuing three months, but should his stay last longer, the traveller can apply to Customs for an extension of the validity of his Certificate. In addition to the small sums in sterling notes and coin allowed to be carried by persons leaving this country for another (Eire again excepted), they are also allowed to carry with them foreign currency notes of the country or countries of their destination to a total value of the equivalent of £10. For example, a person visiting Holland, Belgium and Denmark could take the equivalent of £10 divided at his choice in the form of Dutch, Belgian and Danish banknotes. If it is desired to carry larger sums in foreign currency notes, a Certificate "C" must be prepared by the traveller and submitted through his bankers to the authorities for approval. In such case he must declare on the Certificate "C" all the sterling notes, travellers' cheques and foreign currency *in all forms* which he will have on his person, but approval to the export of currency in the form of foreign currency notes is very seldom given in view of the availability of other forms of payment. Here again, any sum in excess of the total covered by the Certificate "C" which is discovered by the Customs Officers is liable to confiscation. The Immigration and Emigration Officers, both male and female, are said to have discovered some curious hiding places in the course of exercising their powers of search!

Another development of the inter-war years which has been incorporated as a minor factor in the general scheme of an exchange control is the application of a quota system to immigrants according to their countries of origin. "Settlers schemes" have been in operation for many years between this country and some of the Dominions based on the state of the labour market in the receiving country and a careful vetting of the suitability of applicants. These considerations have

been applied, *e.g.*, by the Argentine, Brazil and the U.S.A. to intending immigrants into those countries chiefly from the Continent of Europe. Political developments drove large numbers of people to seek sanctuary abroad but their uncontrolled movements would have been an embarrassment to the countries concerned and arrangements were made for applications for Immigration Visas to be recorded in rotation by the principal Consular Office in the would-be emigrant's country and for the actual Visas to be issued only to a specified number of persons within a given period. In some cases priority was given to persons possessed of special technical skill or ability or who had considerable capital available to them abroad since these classes constitute the most desirable type of immigrant as they can be of benefit to the national economy of the country of their adoption instead of forming a potential charge on national funds as might happen were they unskilled, in poor health or lacking in resources.

In this country refugees from the Continent as the German occupation progressed were given shelter almost without question, and as the great majority of them were able-bodied, educated and had managed to transfer some of their assets here or to Switzerland or the U.S.A. they can be said largely to have been a help rather than a hindrance to our war effort. A fair number, however, had already registered in their own countries, or proceeded to do so here, for admission into the Americas and when they eventually obtained an Immigration Visa the question arose of the re-transfer abroad of such funds as they had managed previously to transfer here. The volume of such re-transfers in the aggregate proved large enough to threaten a severe drain on our most valuable external resources and control was imposed to the extent of allowing the transfer abroad only of the equivalent of gold, exchange or securities surrendered to the authorities under official requisitioning while any other funds had to be left in this country either to be idle or to be invested in specified securities the interest from which was transferable to the owner in his new country. These restrictions, however, have

since been very materially relaxed. Many of these refugees, too, wanted to send money abroad for the maintenance of relatives or friends who had escaped to other countries but were short of funds. Here again a strict system of rationing of exchange was applied based on the degree of relationship between the parties and the minimum requirements of the recipient according to the cost of living in the country where he then was. Every precaution was taken to ensure that in all cases the treatment accorded was scrupulously fair and consistent and the consideration shown must have surprised and comforted many who for long had existed under very different conditions.

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CHAPTER 9

Bretton Woods—The International Monetary Fund—The International Bank for Reconstruction and Development.

FROM the foregoing broad outline of the principles and ramifications associated with the expression "exchange control" each one must draw his own conclusions and form opinions as to the possible shape of the future international monetary structure but, since one guess may be held to be as good as another, the following views are submitted as possible bases of discussion.

It seems that we have the choice of one of three types of international monetary systems :—

(1) A full gold standard, not necessarily with gold coins in circulation, but with open gold markets permitting the unrestricted purchase and sale of gold at or within officially fixed prices and the unhindered import or export of the metal between countries. This means that prolonged disequilibrium of international indebtedness (whether due to the vagaries of nature or to internal economic errors) can only be corrected by upheavals of the internal systems of the countries concerned in that a debtor country must undergo the discomforts and probable ills of more or less drastic deflation while

creditor countries "enjoy" the temporary tonic offered by a dose of inflation. These results are inescapable under any gold standard system working unaided or unchecked. They come about through the generally accepted and in fact essential banking practice of relating cash holdings to deposits and advances. In this country prior to 1914 the Banking Department of the Bank of England was expected to hold in cash about one third of its liabilities in the shape of Public and Other Deposits and Seven Day and Other Bills. The commercial banking system held on the average cash in till and at the Bank of England to about 10 per cent. of the total of its deposits, while advances to customers were not expected to exceed 50 per cent. of the deposits. A gold drain could only take place if a foreign owner of a sterling balance decided to take it away in the form of gold and the required amount of gold could not be purchased in the Bullion market so that it became necessary to exchange notes for gold at the Issue Department of the Bank of England. Such an operation would result in (*a*) the cash holding of the Banking Department of the Bank being depleted by the amount of the decrease in Bankers' Deposits, thus reducing the ratio of cash to liabilities and (*b*) the cash reserves of the commercial banking system being reduced by the amount withdrawn from deposits in the form of gold, thus reducing the ratio of cash to deposits. To restore the position in each case, loans must be called in and bills and securities sold so that the repayments and purchases should reduce the total volume of deposits to a level consistent with the lowered cash holdings. As the amount by which deposits had to be reduced was twice the amount of cash lost by the Bank of England (as the cash ratio was normally 33⅓ per cent.) and nine times the loss by the commercial banking system (as the cash ratio was normally 10 per cent.) a gold loss of £5 millions could possibly cause a total contraction in the national credit structure of £55 millions. This invariably meant tightness of money, a fall in security values and eventually of prices generally, a reduction of output and manufacturing programmes,

unemployment and all the concomitants of a "slump". Conversely, a potential credit expansion in the ratio of eleven to one would be created by an influx of gold (such as might be induced by a rise in the exchange value of the £ caused by a flow of foreign funds to this country for investment after a rise in Bank Rate or the repayment of a foreign loan) as the cash reserves of both the Bank of England and the commercial banking system would be increased by the same amount as the increase in deposits. This would lead to easiness of money, a rise in security values and the general level of prices, increased industrial activity, greater employment and "boom" conditions. In either case, however, the *entire domestic economy* is disturbed by gold movements arising exclusively from causes associated with the *external* affairs of the country.

(2) A gold standard fully operative as regards our external relations but with planned control of the internal effects of gold movements, *i.e.*, "management" of internal currency and credit. Such a system would, in theory, give the best of both worlds but in practice is bound to fail since the only method of preventing an efflux or influx of gold from affecting the internal credit system would be by expanding or contracting credit respectively so as to maintain a reasonably constant volume of credit. This could only be done by :—

(*a*) Continued variations in the recognized ratio of cash to public liabilities both of the Bank of England and of the commercial banking system so that in the case of an efflux the Bank would restore in whole or in part the cash reserve of the commercial banks by purchasing bills and securities or by loans to the market (the result of which would be to leave the Banking Department with unchanged or only partly reduced public liabilities against a cash holding depleted to the full extent of the gold drain and consequently showing a proportionately reduced ratio) while the commercial banks would have to accept a depletion of their cash reserves to the extent that they were not restored by the Bank, against a decrease in public liabilities of the full

amount of the efflux ; but unless the cash reserves were fully restored by the Bank a lower ratio of cash to deposits must result. In the case of an influx the Bank would prevent the increase in the cash reserve of the commercial banks from becoming operative as a basis for credit expansion by calling in loans or selling bills and securities until the volume of bankers' deposits was wholly or partially restored to its former level and such portion of the proceeds of the influx as was not absorbed in this way would have to be allowed by the commercial banks to remain as an unprofitable asset and merely to show as a higher ratio of cash to deposits —rather a lot to expect from profit-making institutions responsible to their shareholders !

(*b*) Variations in the fiduciary note issue which would need legal authority and which would mean that an efflux of gold would require an increase in the note issue of an equivalent amount against securities, which could only be provided either by the Banking Department of the Bank or by the commercial banks themselves (in either case a profit-earning asset would be exchanged for an unprofitable one) while an influx of gold would have to be accompanied by a handing over of notes against securities either by the Banking Department of the Bank or by the commercial banking system or by both in part. In any case such steps could only act as temporary palliatives since they would not touch the basic causes of the gold movements which must be either over-spending or over-lending abroad or a money price for gold which is out of alignment with the purchasing power of our money over other commodities and services. Moreover, any weakening or strengthening of our financial system would undoubtedly be accompanied by an efflux or influx of capital thus accentuating the movement which had its origin in other causes.

(3) Planned "management" (as distinct from actual official control of trade and exchange) of both the internal and external financial economies of the country which may require to be extended to the commercial field in greater or lesser

degree and with gold as the accepted international medium for the discharge of temporary balances of indebtedness. Such a system was in course of international development immediately prior to the war and appeared to be working smoothly and efficiently. Without going into too much detail of currency history from 1919 to 1939 it may be said that the first of these two decades was a general struggle to return to a gold standard on or as nearly as possible to pre-1914 lines. It has been argued that this of itself was a basic cause of the financial and political upheavals of 1929 to 1931 since varying economic and political conditions in the principal countries of the world caused movements of capital in bulk which could only be carried out by gold transfers which, in turn, caused successive contractions and expansions of credit with the usual repercussions on trade, finance, industry, employment and consuming power. This country was the first to attempt to build a new system from the ruins of the old and the establishment of the Exchange Equalization Account in 1932 opened a new chapter in world history of currency "management," again as distinct from actual exchange control.

The strenuous efforts which had been made during 1931 to preserve the gold bullion standard which was introduced in 1925 but which had eventually to be suspended in September, 1931, had very seriously depleted our external resources, but as soon as it became apparent that very drastic steps were being taken to put our house in order and to restore our political and financial stability, foreign-owned capital previously withdrawn from this country began to flow back and the resulting demand for sterling enabled the authorities here steadily to accumulate a reserve of gold and foreign exchange while they also acquired most of the South African gold output which was normally marketed in London. Even after discharging certain pressing external obligations the authorities soon felt their position strong enough to assume management of the principal foreign exchanges and of the bullion market, and began to sell and buy exchange and gold at prices *fixed by themselves but varied from time to time according to the*

trend of events and the degree of pressure from the respective markets. This management of external monetics was accompanied by a new technique of management of internal currency and credit which needs to be explained in some detail.

(*a*) The Exchange Equalization Account was capitalized almost entirely by Treasury bills issued by H.M. Treasury and these needed to be discounted to provide the authorities with such liquid funds in sterling as they required.

(*b*) When conditions required the authorities to buy, at their own price, exchange or gold against sterling they paid for it by a transfer of funds from their account with the Banking Department of the Bank of England to that of the clearing agent of the foreign buyer of sterling, *i.e.*, "bankers' deposits" (or bank cash) increased. The deposits of the commercial banking system would be increased to the equivalent of the increase in cash reserve by the credit to the account of the foreign buyer of the amount of sterling purchased. Thus, the same result on the banking system was shown as with an influx of gold *but the position of the Banking Department of the Bank was unaffected* in regard to its cash ratio so that one potential of credit inflation under a gold standard did not arise under the new system of management.

(*c*) To eliminate the credit inflation potential shown in (*b*) and to provide the liquid funds which they had disbursed, the authorities sold Treasury bills to approximately the amount of the previous sales of sterling, to the market generally and to those banks in particular whose deposits (and consequently cash reserves) were most affected. Payment for these sales was eventually made by a transfer of funds from the account of "bankers' deposits" to that of the authorities in the Banking Department of the Bank *thus depleting the cash reserves down to approximately their former level* and again leaving the position of the Bank itself unchanged.

The authorities, therefore, in the end had bought exchange or gold against sales of Treasury bills and an influx of capital into the country of no matter what size had caused no more disturbance to our internal economy than the passing of a

number of book entries. The genius of this technique lies in its simplicity.

(*d*) When conditions required the authorities to sell exchange or gold they received payment by a transfer to their account from " bankers' deposits " in the Banking Department of the Bank. The position of the Bank was unchanged, but the banking system had lost cash to a sum equal to the reduction in its deposits by the withdrawal of foreign-owned funds—a situation which would have required more or less drastic deflationary action under a gold standard. Under the new system the authorities merely used the increase in their liquid funds to buy Treasury bills, particularly from those banks who had suffered the largest withdrawals, to an amount approximately that of the sterling which they had acquired. As a result of these purchases, funds were transferred from the authorities' account to that of " bankers' deposits " and the ratio of bank cash to deposits was thereby restored without the whole internal economy of the country having to suffer a deflationary purge and merely by the passing of a number of book entries.

The insulation of our internal monetary economy from the effects of exchange operations against or in favour of sterling due to external factors was therefore complete, and the authorities were able to preserve reasonably stable internal conditions while bowing somewhat to the winds of external disturbances and *allowing the sterling price of gold and other currencies to fluctuate at their discretion* but not to an extent which would create under- or over-confidence abroad in the financial and commercial position of this country.

International conditions soon after forced other countries to adjust the price of gold in terms of their own currencies to the current purchasing power of those currencies in terms of other commodities and to adopt methods of external and internal monetary management and this led to the first move in history towards international co-operation in the management of currency and credit. On 13th October, 1936, the Secretary of the U.S. Treasury announced that a

Tripartite Agreement had been entered into by the Governments of the U.S.A., Great Britain and France under which any operations by the respective exchange funds in the currencies of either of the other parties would be held covered by gold *at the price ruling on the day in question.* Covering arrangements had to be made at the close of each business day and any foreign currency balances not so covered were considered to be needed by the holder and were not eligible for subsequent conversion into gold. Belgium, Holland and Switzerland joined in this agreement shortly afterwards and a remarkable degree of stability and team-work was achieved. It must be remarked that while the authorities concerned would buy gold from all and sundry, they would only sell to each other or to another Central Authority and each of them prohibited exports of gold except under licence which was usually only granted in respect of small shipments for commercial purposes. As far as the contracting countries were concerned, therefore, international speculation in gold, with its inevitable effects on exchange rates and credit conditions, was eliminated. The internal price of gold in each country was, of course, fixed on the basis of current external exchange rates and remained unaltered until circumstances demanded a revision of those rates when all the exchanges concerned (*i.e.*, those with the other parties to the Agreement) *and* the internal price of gold were moved simultaneously to the desired new level.

The differences between this international system of "management" of internal and external currency values and credit volume and "control" of currency values either by gold or by conscious planning are quite distinct. Under the first system no restrictions were placed officially on the purposes for which exchange and gold could be bought and sold; the only limits to the activities of firms or individuals were those imposed by the commercial banks as a matter of ordinary business prudence. The movements which were allowed to take place in exchange rates and gold prices were, for this reason, somewhat sudden, and on occasions violent,

and were entirely at the discretion of the authorities concerned, *i.e.*, pure "management". Under a gold standard again no restrictions on the purposes for which gold and exchange could be bought and sold were officially imposed, but this freedom brought about frequent large movements of gold with resultant disturbances of internal credit conditions in both the countries concerned which could not be completely cushioned. Under a full system of exchange control the authorities have power to refuse exchange for any but essential purposes, and the most recent practice has been to use every effort to avoid any alteration in exchange rates so as to induce a feeling of stability and long-term confidence.

It would appear, therefore, that complete freedom of operation in both exchange dealings and credit conditions is not only extremely difficult but undesirable to attain. The first-mentioned system gives freedom of dealing and insulates the internal economy of the country from external shocks, but offers no long-term stability of exchange rates—a most important matter to exporters when planning manufacturing and sales programmes. The gold standard system offers freedom of dealings, stability of rates and, coupled with a certain amount of "management", a reasonably stable but, where necessary, elastic credit structure, but in the past it has led to enforced inflation or deflation internally owing to governmental reluctance to effect a change in the official gold price until disequilibrium between that price and the general internal price level has resulted in such a depletion or accretion of gold stocks as to render such a step unavoidable; meanwhile the consequent over- or under-valuation of the currency in terms of others will have penalized severely either exporters or importers, and in addition, speculators in the currency will have accentuated the maladjustment. Under a complete system of exchange control the operations of traders are subject to official policy, while those of financiers are reduced to the bare minimum of capital requirements, and those of speculators eliminated; on the other hand, in this country at least, a very high degree

of long-term stability of exchange rates and internal prices has been achieved and the credit structure has been almost completely segregated from external affairs.

Each method, therefore, has its advantages and its drawbacks, but modern views as to the requisites of an international monetary system were set out in the Final Act of the United Nations' Monetary and Financial Conference held at Bretton Woods, New Hampshire, U.S.A., from 1st to 22nd July, 1944 (Cmd. 6546 of August, 1944). Though it contains many debatable points this plan is a most constructive effort on the part of international monetary experts to set up the framework of an international monetary system which shall combine reasonable long-term stability of exchange rates and gold prices with a certain elasticity in case of need and which, while envisaging the removal of exchange restrictions and control, at the same time limits the purposes for which exchange may be freely bought and sold. The basis of the Plan is that the currency of each member country shall be given a "par value" in terms of gold as a common denominator or in terms of the United States dollar of the weight and fineness on 1st July, 1944. (On 31st January, 1934, the U.S. dollar was given a legal gold content of 15 5/21 grains of gold nine-tenths fine and simultaneously the Federal Reserve Bank of New York was authorized by the Secretary of State to buy and sell all gold offered to or demanded from it at the fixed price of $35 per fine ounce Troy, less the usual minting charges when buying and with a handling charge of one-quarter of 1 per cent. on both purchases and sales. These decrees have since remained unchanged, and the Federal Reserve Bank has even sold gold in bulk during the war; the U.S. dollar is therefore the sole remaining world currency on an effective gold standard). The "gold motif" runs through the whole of the plan and other relative proposals may be summarized as follows:—

(*a*) A "quota" is fixed for each member to subscribe to the "pool" of exchange to be created for the Fund.

These quotas shall be generally reviewed by the Fund every five years or specially in case of need at any other time. They must be paid as to 25 per cent. in gold or 10 per cent. of the member's net official holdings of gold and U.S. dollars, whichever is the smaller, and the balance in the member's own currency. Increases or decreases in quotas shall be effected by the deposit or release of gold or gold and U.S. dollars, and the member currencies concerned in the same proportions as above.

(*b*) To preserve the "gold value" of the Fund's assets any member granted a reduction in the gold value of its currency must deposit an amount of its own currency sufficient to restore to its former level the gold-purchasing power of its original quota deposit, *e.g.*, if an original par value of 100 units of currency per ounce is reduced to 120 units per ounce and the original quota deposit in that currency was and has remained at one million units, an additional deposit of 200,000 units must be made so that the total deposit will still purchase the same number of ounces of gold as formerly.

(*c*) The Fund is empowered to levy charges on all dealings with it by members, whether in gold or exchange, and all such charges must be paid in gold.

The most important of the gold provisions is, of course, the fixation of gold parities for member currencies. The Plan provides that the Fund shall notify members when it considers that it will be in a position shortly to begin exchange transactions, and that within the next thirty days each member shall communicate to the Fund the par value of its currency *based on the rates of exchange prevailing on the sixtieth day before the entry into force of the Agreement* ; this is laid down as the date on which the Agreement has been signed on behalf of Governments having 65 per cent. of the total of the quotas, but not prior to the 1st May, 1945. Within ninety days of the request for the fixing of a par value being received, a member may notify the Fund that it regards the par value calculated as above as unsatisfactory, or the Fund may notify the member that it considers that such a par value

could not be maintained by the member without undue recourse to the resources of the Fund. Some basis for argument is here disclosed, but the Fund has the last word as, should agreement on a par value not be reached between the Fund and the member concerned *within a period determined by the former*, the member shall be deemed to have withdrawn from the Fund at the expiration of such determined period.

The result of the fixation of such gold parities would be, however, at once to afford stable exchange rates between the Nations as each currency could be expressed in terms of the others through the common factor of gold, as may be shown thus :—

Country	*Price of gold per ounce*	*Exchange parity per £*
U.K.	£9	—
U.S.A.	$36	$4
France	Fcs.1,800	Fcs.200
Italy	L.3,600	L.400
Holland	Fl.90	Fl.10

Therefore Fl.100 would equal Fcs.2,000 or L.4,000, $1 would equal Fl.2.50 or Fcs.50, and so on.

Stability of such exchange rates is provided for by requiring members :—

(*a*) If they deal in gold, to buy and sell gold at prices not exceeding a margin *prescribed by the Fund* below and above the fixed gold parity (which prevents wide fluctuations in the monetary price of gold) ;

(*b*) To ensure that the maximum and minimum rates of exchange for transactions in "spot" exchange in the currencies of other members shall not differ from parity "by more than 1 per cent." This appears to mean that the maximum rate and the minimum rate may each differ from parity by 1 per cent., giving a maximum range of fluctuation in the exchange rate of 2 per cent.

(*c*) To ensure that "other exchange transactions" (which must, of course, include "forward" dealings) in the currencies of other members are not carried out at rates showing

a margin over and above the margin for "spot" exchange against the par rate of *more than the Fund considers reasonable.*

To back up these provisions for stability of exchange rates and to furnish resources for their implementation, members are to have access to the resources of the Fund under certain conditions and on specified terms. A member shall be entitled to buy the currency of another member from the Fund in exchange for its own currency provided that the Fund has not given notice that its holdings of the currency desired have become scarce, that the purchaser represents that the currency is "presently needed" for making payments which are consistent with the provisions of the Agreement, and that the proposed purchase would not cause the Fund's holdings of the purchasing member's currency to increase by more than 25 per cent. of its quota during the period of twelve months ending on the date of the purchase, nor to exceed 200 per cent. of this quota. The 25 per cent. limitation applies only to the extent that the Fund's holdings of the member's currency have been brought above 75 per cent. of its quota if they had been below that amount. This seems to mean that, to take this country as an example, with a proposed quota of £325 millions, the Fund would normally hold roughly £245 millions in sterling as part of its resources, and that it would be ready to acquire a further £81 millions against the sale to our authorities of other member currencies during any twelve months ending on the date of the transaction bringing the total to this latter figure, *i.e.*, if on the 1st January, 1948, the Fund held £245 millions and on the 31st March, 1948, our authorities purchased foreign currencies against sterling to the amount of £40 millions, and on the 30th June, 1948, they purchased currencies to a value of a further £41 millions, they could make no further purchases from the Fund until the 1st April, 1949. In view, however, of the limitation of purposes for which international payments may be made within the framework of the Plan, these facilities offer a substantial bulwark for the maintenance of existing exchange parities.

The possible effects on our internal credit structure of purchases and sales of foreign currencies by our authorities from and to the Fund are discussed later.

Further backing is afforded by provisions that members[1] may purchase other currencies either from the Fund or from each other in exchange for gold so that metallic reserves would ordinarily be used to provide exchange needed to meet a temporarily adverse balance before the member concerned had recourse to the exchange facilities offered by the Fund. Members can also deal in exchange with each other in respect of current requirements, but all these provisions require that a purchasing or borrowing member shall represent to the seller or the Fund that the exchange concerned is "presently needed for making payments for current transactions", *i.e.*, members are not permitted to accumulate and hoard other currencies as a hedge against possible future needs.

More general steps to be taken in the interests of exchange stability are that :—

(*a*) Members undertake to maintain orderly exchange arrangements with other members and to avoid competitive exchange alterations.

(*b*) Members shall not without the approval of the Fund impose restrictions on the making of payments and transfers for current international transactions.

(*c*) No member or any or its fiscal agencies shall engage in discriminatory currency arrangements or multiple currency practices.

(*d*) Members shall withdraw any existing exchange restrictions as soon as they are satisfied that they will be able in the absence of such restrictions to supply their balance of payments in a manner which will not unduly encumber their access to the resources of the Fund and that not later

[1] The Fund, however, will only deal with the Treasury, Central Bank, stabilization fund, or other similar fiscal agency of a member, and dealings between members must be conducted only by such agencies.

than three years from the date of commencement of operations by the Fund it shall report on any such restrictions which are still in force and after five years the Fund may take steps to secure the removal of any such restrictions as may still remain.

(*e*) International transfers in respect of capital movements shall be strictly controlled, and members may not make net use of the Fund's resources to meet a large or sustained outflow of capital.

(*f*) The only purposes for which exchange may be freely bought or sold or transfers of funds abroad permitted are :—

1. All payments due in connection with foreign trade, other current business including services, and normal short-term banking and credit facilities ;
2. Payments due as interest on loans and as net income from other investments ;
3. Payments of moderate amount for amortization of loans or for depreciation of direct investments ;
4. Moderate remittances for family living expenses.

   (Members may consult with the Fund as to whether any specific transaction is to be regarded as a current permissible payment or as a capital movement.)

From the point of view of this country the effects on our internal credit structure of the above-mentioned proposals must depend entirely on the degree to which our authorities will be permitted by the Fund or by international opinion to " manage " that structure. It would seem that should we buy other currencies from the Fund the resulting sterling deposit would be effected by debiting the official account with the Bank of England and crediting the Fund's account with that institution ; this would leave the position of the Banking Department of the Bank unchanged and would not affect the commercial banking system. When, however, the foreign currency so acquired was sold to buyers here, payment could be made only by a debit to " Bankers' Deposits " at the Bank and a credit to the official account.

At the same time, however, the commercial banking system would find its cash reserves depleted to the same extent as the reduction in its deposits (as would occur with an outflow of gold under a gold standard), and if enforced deflation, varying according to the size of the purchases of foreign exchange, were to be avoided it would be necessary for the authorities to purchase bills and securities from the Money Market in order to restore the necessary ratio of cash to deposits. But this would result in the commercial banks being forced to sacrifice interest-bearing assets in order to rebuild their cash reserves while the funds with which to make such purchases would have to be created by advances to the official account by the Bank since official funds would have been used in the original purchase of the exchange and would merely be restored by the proceeds of re-sales. Under Article III of the eventual constitution of the Fund, however, funds standing to its credit in any centre can be invested in notes or similar obligations officially issued by the country concerned and which shall be non-negotiable, non-interest bearing, and payable at their par value on demand by a re-credit to the Fund's account. When this is carried into practice, the result would be that the Government concerned would again have money at its disposal which could either be disbursed through normal Government payments or used for the redemption of short-term debt, such as Treasury Deposit Receipts or Treasury Bills which would eventually restore the level of the cash reserves of the commercial banking system.

Purchases of exchange either from the Fund or from other members against gold would leave the existing position unchanged. The original purchase of the gold by the authorities would, however, have created a base for credit expansion in that payment would have been made by a transfer from the official account to "Bankers' Deposits" followed by a credit to the seller's account with a commercial bank so that the commercial banking system would have its cash reserves increased to the same extent as the increase in its deposits as with an influx of gold under a gold standard. To

counteract this potential the authorities would have to sell bills or securities to the Money Market until the excess cash was absorbed. When the gold was used to purchase exchange the eventual sales of such exchange would deplete the cash reserves of the banking system to the same extent as the decrease in deposits and this would call for reverse action on the part of the authorities in that they would have to buy bills or securities until the cash ratio was restored.[1]

Purchases or sales of exchange against sterling would leave the position both of the Bank and the banking system unchanged as a certain amount of sterling already in existence in the banking system would merely change hands from domestic to foreign ownership.

It is evident, however, that a highly specialized technique would have to be developed in regard to the management of the internal credit structure in order that the necessary elasticity should be preserved and any appropriate contraction or expansion of credit allowed to follow an efflux or influx of sterling through any of the methods outlined above as might be called for by an examination of the causes underlying such sterling movements.

Let us now consider the practical application of the Plan. As has already been stated the fixation of the gold par values of currencies may be a matter of subsequent adjustment, but it is provided that these par values shall be initially determined on the basis of the rates of exchange for each currency prevailing on the 60th day before the entry into force of the Plan. Such pars are, however, evidently regarded as experimental because within three months of the notification of the initial par value the member concerned may inform the Fund, or the Fund may inform the member, that the proposed par value is unsatisfactory ; if in the course of subsequent discussions the Fund and the member cannot agree upon a new par value "*the member shall be deemed to have withdrawn from the Fund.*" Once the par value has been

[1] The "Treasury Deposit Receipt" system would also doubtless be used for such purposes.

fixed between the Fund and the member the following provisions are laid down :—

(*a*) A member shall not propose a change in the par value of its currency *except to correct a fundamental disequilibrium.*

(*b*) A change in the par value of a member's currency may be made only on the proposal of the member and only after consultation with the Fund.

(*c*) Where a proposed change does not exceed 10 per cent. of the *initial* par value the Fund shall raise no objection, but if such a proposed change would cause a variation of more than 10 per cent. of the initial par value the Fund may either concur or object, but it may not object merely because of the domestic, social or political policies of the member concerned.

(*d*) Where a member changes the par value of its currency without consulting or in the face of objections by the Fund the member may be declared by the Fund as ineligible to use its resources and may eventually be required to withdraw from membership.

Unfortunately, the Plan does not disclose the factors to be used by a member wishing to demonstrate the existence of a "fundamental disequilibrium" which it must do when proposing any change in the initial par value of its currency. Since one of the avowed objects of the Fund is "to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members" it is to be hoped that the very first symptoms of disturbances to the internal economic system will be sufficient to demonstrate the need for a change, provided such disturbances can be related to the existing level of exchange rates. If, however, a member will be expected to use its gold reserves and its facilities for purchasing other currencies from the Fund to maintain an existing parity until such time as a pronounced change in the internal price level, volume of employment and level of wages has taken place (as a result of a maladjustment of the internal price level and the monetary price of gold based on the fixed parity), this might be regarded as re-imposing a good deal of the rigidity of the former type of gold standard

to which so much objection was taken in many quarters. It is unfortunate that the intentions on this point were not clarified in the course of the discussions on the Plan which took place in the legislatures of the world.

There is also the question of the provision of facilities for the "forward" covering of exchange. The reference to this in the Plan is oblique, but as even in fairly normal times most merchants are reluctant to speculate in exchange and much prefer to cover their commitments as and when they arise by means of a "forward" operation, it seems likely that in the disturbed conditions of world trade and finance which must necessarily supervene for some years after the conclusion of hostilities a very definite lead as to the means and methods by which forward exchange facilities will be provided should be given. It is laid down that a member shall not be entitled without the permission of the Fund to use the Fund's resources, *i.e.*, take advantage of its exchange facilities, to acquire currency to hold against forward exchange transactions; but no British bank cares to run an open exchange position, and if requested by a customer to provide forward exchange facilities would inevitably require some means of covering the resulting liability. We need to know, therefore, whether the forward market will be expected to satisfy itself by offsetting sales against purchases, whether the restriction on forward margins as against spot imposed by the Fund is rigid or elastic so that variations in the volume of supply and demand or in interest rates at home or abroad may be allowed to manifest themselves in changes in the existing forward margin, and whether any precise set of conditions will have to be demonstrated to the Fund before its permission to acquire currency as cover for forward transactions will be given. These points are of fundamental importance since an active forward exchange market will be absolutely essential in the restoration of international trade and commercial services.

The Plan lays down several other principles and rules of procedure which need not be examined in detail, and the above comments are made to throw up some of the problems which

must be solved in any scheme for the establishment of a new or even revised old international monetary system. While perhaps the world picture must first be sketched in outline there are certain essential details which must be filled in before the work can be offered to the public even in an experimental state and informed criticism is impossible in the absence of the necessary data. To this country, perhaps the most interesting of the objects of the Plan is "to assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade." This is elaborated in the Plan in the provisions for the early removal of exchange restrictions and the abrogation of existing bilateral agreements. As the several canalized forms of sterling came into being as the result of bilateral agreements, the adoption of such a principle by this country will mean that it will once more be possible for a Brazilian to buy Iranian carpets, have them freighted in an American vessel and re-sell them to other South American countries all in terms of sterling, the various payments being effected by transfers in the books of United Kingdom banks.

The Plan was accepted by the representatives of forty-four countries attending the Conference, and it was agreed that, if countries representing 65 per cent. of the proposed resources of the Fund ratified by legislation before 31st December, 1945, their intention to become members, the Fund should be duly constituted and should commence operations in due course. By the date fixed, thirty countries, including Great Britain, Canada and the U.S.A., but excluding Australia, New Zealand and Russia, had passed the necessary legislation and had become "original" members of the Fund. Australian opinion at first held that membership of the Fund seemed likely to place Australian internal economy too much in the hands of the preponderating foreign influence on the Board of the Fund, but early in 1947 this view was modified and Australia applied for "original" membership, in spite of the

fact that she was over a year late, but it was, of course, granted. New Zealand has not applied for membership up to the time of writing. Russia has so far held aloof, but with her special political régime and state-trading organizations she undoubtedly feels it impossible for her to comply with the letter of the Fund's requirements, even though it is sincerely to be hoped that she will conduct her monetary affairs with the rest of the world in the full spirit of those requirements. The Fund was, therefore, legitimately born, and in accordance with its constitution, appointments to the Board of Governors were made by those countries entitled to a seat. An American was, of course, elected Chairman, but this office has already changed hands once, and it can be no easy task to reconcile the varying temperaments and outlook of a number of persons of different political and economic views.

During 1946 the Fund called on its members to pay up 1 per cent. of their respective quotas to cover the preliminary expenses of its inauguration, and later in the year asked that initial parities should be declared as it would shortly be ready to commence business. Thirty-one countries declared their existing rates of exchange as the basis of their initial parities, including this country and all the countries of the British Commonwealth and Empire, but eight areas, including Poland, Greece and Yugoslavia, asked for more time. The Fund actually opened for business on 1st March, 1947, and called up the remainder of the quotas due by members. On 27th February, 1947, this country, having already paid up just over £1 million on account of its quota of £322,580,000, handed over to the Fund £51,203,000 in gold and credited the account of the Fund with the Bank of England with a sum of £270,345,000. This amount was raised by Government borrowing from the Bank of England, but the Fund immediately invested £238,075,000 of its new sterling balance in British Government non-interest bearing Notes, thus enabling the advance from the Bank of England to be repaid almost in full. The other member countries made similar transfers of gold and/or dollars and passed similar credits in terms of their

own currencies to the account of the Fund with their Central Bank, and the Fund started business with holdings of gold and U.S. dollars to a value of nearly $4,000 millions, and of more than the equivalent of the same sum in the currencies of its thirty odd members. In the first four months of its existence the Fund sold $50 millions to France, and $6 millions and £1½ millions to Holland. By November, 1947, this country had purchased a total of $240 millions.

Although, in the first three years after the conclusion of hostilities, world progress in rehabilitation and reconstruction was nothing like so rapid as had been hoped for, and world economy was seriously affected, first by the cessation of Lease-Lend facilities and then by a shortage of foodstuffs and a major rise in prices in the Americas, followed by the introduction of the Marshall Plan for European Recovery, the Fund has at least commenced to justify its existence and to function, even if in a very limited fashion, according to its concept. The capital reconstruction of war-ravaged countries is obviously not a matter which could be financed even out of the exceptional resources possessed by the Fund, whose sole purpose is to offset the discharge of *current* international obligations. Neither is it the function of the International Bank for Reconstruction and Development (to which reference is made later) to provide long-term capital for the restoration of war-shattered national economies. The huge adverse balance of payments between Western Europe and the Americas was due solely to expenditure on imports for capital reconstruction, and the U.S. dollar became a highly scarce currency for the importing countries, but the Fund had ample dollar resources which it was quite prepared to place at the disposal of its members, in accordance with its constitution, for *current* purposes. If American Aid to Europe gives the anticipated results and European economics are revived, then the Fund should come into its own and provide a most valuable lubricant for the wheels of international trade.

The Bretton Woods Conference also produced a Plan for the formation of an International Bank for Reconstruction

and Development, and this Plan was accepted concurrently by those countries which accepted membership of the International Monetary Fund. In due course, therefore, the Bank was constituted and commenced operations. Like the Fund, these resources were provided by quota subscriptions by members to the shares of the capital stock of the Bank of which 20 per cent. was due to be paid on or prior to the commencement of operations by the Bank, and the remaining 80 per cent. was to remain subject to call by the Bank as and when its operations required the calling up of further capital. Of the initial 20 per cent. of such subscriptions for shares, 2 per cent. was payable immediately in gold or United States dollars, and the remaining 18 per cent. was payable in the currency of the particular country concerned as and when called up by the Bank. Any calls on the remaining 80 per cent. of the capital subscription may be made at the option of each member, either in gold, United States dollars, or in the currency required by the Bank to discharge the obligations for which the call is made. It will be noted that there is a marked difference in the constitutions of the Fund and the Bank, in that only 18 per cent. of the quota subscription of any member is automatically payable in terms of the currency of that member. The only occasion when a member's own currency could be tendered to the Bank as a quota subscription in addition to the original 18 per cent. would be if the Bank itself required the currency of the member concerned for the purpose of meeting its own obligations. If, for example, the Bank were to arrange a loan in Belgian francs to France and made a call on members for funds to meet its obligation, Belgium for one could tender in Belgian francs the full amount of her quota of the call-up, while other members would have the option of paying their quotas in either gold, U.S. dollars or Belgian francs, according to their choice.

The constitution of the Bank does not permit it to make loans for relief purposes or as temporary "first aid." It is only allowed to make or guarantee loans which are made to particular countries for the development of specific productive

resources which will themselves in due course provide the increased production out of which the service of the loans should be payable. In the first year of business the Bank made several loans to member countries out of its own resources, but only after searching inquiry into the purposes for which the loans were required, the prospects of a resulting increase in productive capacity sufficient more than to cover the service of the loan, and the past history of the prospective borrower in regard to earlier borrowings. The Bank has also negotiated for the issue of its own bonds (not to be confused with its own shares) in both Switzerland and Holland in terms of Swiss francs and Dutch florins respectively, so as to enable it to make loans in those currencies to other members desirous of raising funds in one or other of those currencies. By the middle of 1948, the Bank had entered into twelve Loan Agreements totalling \$525 millions, of which over \$200 millions had been loaned to Holland. Such a total was of course a most welcome addition to the world's scanty dollar resources.

The Managing Director of the International Monetary Fund reported that during the period from 1st March, 1947, to 30th September, 1948, it had completed exchange transactions with members aggregating U.S. \$622.4 millions, Belgian francs 500 millions, and British sterling £1½ millions. Such transactions, of course, again afforded a very useful supplementary fund of exchange, but the operations of the Fund have been restrained owing to the continuing disequilibrium in the balance of payments between member countries which results in only a few being creditors and the majority debtors. As the Fund pointed out in its Report, it cannot indefinitely continue to sell the currency of any particular country as a point must be reached where further sales of any given currency would have the effect of compelling that country to finance a larger bilateral surplus with another country by making net drawings on its resources of gold and exchange. The Fund must also take into consideration the probable inflationary effects of requiring a member country

to create new balances in its own currency for expenditure within its border so that, while exports by it are paid for out of such new credits, no compensating imports arrive within it to absorb the freshly created internal purchasing power. There can be no doubt, however, that if Marshall Aid to Europe results in the restoration of European economies on a sound basis with the disappearance, or at least a minimizing, of the existing disequilibrium in their relative balances of payment, the resources and growing experience of the Fund will enable it to play a major part in smoothing out temporary adverse balances on current transactions and in facilitating legitimate movements of capital designed to increase the general productivity.

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CHAPTER 10

The Anglo-American Loan Agreement—Lease-Lend settlement—The release or funding of "frozen" balances—The attempt to restore the international convertibility of sterling—Steps following the suspension of convertibility—Current types of sterling—The Exchange Control Act, 1947.

As was mentioned in an earlier chapter, a large proportion of the imports needed by this country for its war effort were supplied by the United States under Lease-Lend arrangements, and when eventually the United States entered the war, this country was able to provide her with a certain amount of assistance on similar terms so that Lend-Lease worked both ways. Soon after the conclusion of hostilities, however, it became apparent that the enormous amount of reconstruction and re-equipment which this country would require to restore even partially her war-shattered economy could not possibly be financed out of her greatly reduced overseas resources and export capacity. The United States evidently recognized the supreme strategic importance of this country, and were prepared to assist in the work of recovery on their own terms.

Following the Bretton Woods Conference, protracted negotiations took place in regard to the essential financial assistance which this country required. On the most optimistic forecast it was estimated that it would take four years to restore our economy to a reasonable state of efficiency, and that during this period the deficit between income and expenditure overseas would amount to at least £1,500 millions. It must be remembered that the work of reconstruction and the replacing of worn-out or obsolete equipment is quite a separate problem from that of meeting any deficit arising from an excess of normal imports over normal exports. The former is a capital outlay and, in addition to the actual materials required, those engaged on the work must be paid, clothed, and housed, and considerable imports are needed for this purpose. Moreover, the work of those so employed is not immediately productive. If a given amount of raw material and labour is devoted to the production of manufactured articles, or primary products, an immediate sales return can be obtained either at home or abroad. For example, by the import of fertilizer from Chile and the employment of a certain amount of labour, a certain quantity of cereals could be produced which would not only help to feed those employed in other productive activities, but would also reduce the need to import foodstuffs, while those engaged on other tasks would be producing goods partly for the use of their fellow-countrymen and partly for export so as to raise proceeds out of which payment for imports could be made. Imports for the purpose of capital reconstruction and re-equipment, however, only produce saleable results after a considerable lapse of time, and the financing of such imports should have been made a separate and distinct problem not only for this country, but for all the other war-ravaged countries, but this does not seem to have been appreciated by those in authority.

Eventually an agreement was reached between the Governments of the United States and the United Kingdom under which the former Government extended to the latter a " line of credit " of $3,750 millions, *i.e.*, nearly £940 millions, which

could be drawn on at any time between the effective date of the Agreement and 31st December, 1951, inclusive. It will be noted that the sum actually advanced by the United States was very much less than the amount estimated to be required by this country over the ensuing four years, quite apart from any extra conditions or requirements, such as were actually attached by the United States under the Agreement. The purpose of the line of credit was set out as being to facilitate purchases by the United Kingdom of goods and services in the United States, to assist the United Kingdom to meet transitional post-war deficits in its current balance of payments, to help the United Kingdom to maintain adequate reserves of gold and dollars, and to assist the United Kingdom to assume the obligations of multilateral trade. All conditions in this formula should be noted : first, that the advances were for purchases only in the United States ; and, secondly, that this country should assume the obligations of multilateral trade (which is dealt with below). The total amount drawn under the line of credit as at 31st December, 1951 (when the credit expired), became subject to interest at the rate of 2 per cent. per annum, and this rate became chargeable at the commencement of each successive year on the unredeemed balance of capital and interest outstanding as at the previous 31st December. Repayment of capital and interest is to be made in fifty annual instalments beginning on 31st December, 1951, the first forty-nine instalments being of equal amounts and the final instalment slightly larger in order to complete the redemption. There is a definite obligation on this country to repay all capital drawn under the line of credit by annual instalments, as above, but there is a minor measure of relief in regard to accrued interest which the United States is willing to waive in respect of any twelve months if the International Monetary Fund certifies, on the basis of an agreed formula, that there is a certain deficit in our international balance of payments.

The United States obviously regarded this country as the only credit-worthy borrower for the time being, and imposed

certain conditions designed to make sterling the bridge between the U.S. dollar and all other currencies. The first condition was that the Sterling Area dollar pool should be dissolved and that any sterling balances accumulated by Sterling Area countries should be freely available for use for current transactions in any currency area. The so-called "Sterling Area Dollar Pool" was instituted immediately on the outbreak of war, and was merely an arrangement under which the dollar earnings and income of all the countries who were members of the area (including, of course, this country) were placed at the disposal of the United Kingdom Government, which then made allocations out of this general pool to itself and to the other Sterling Area countries on the basis of the minimum requirements of each during the ensuing six or twelve months, these figures being thrashed out by discussions between the home Government and the Governments of the other countries of the area. This, of course, resulted in several Sterling Area countries accumulating sterling balances which they could not use (to which reference is made later), and so sterilized a certain amount of purchasing power, while the severe limitation of the dollar allocations necessarily meant smaller purchases from the United States. The object of this condition was, therefore, solely to make this country responsible for not permitting any further increase in the existing volume of pent-up purchasing power represented by the idle sterling balances of other Sterling Area countries, and for the immediate and unhindered conversion into any other currency of any further sterling becoming due to other Sterling Area countries as a result of current transactions. The United States knew very well that as a result of their high-geared production developed as a result of their enormous war effort, they would be by far the best source of supply of primary products and capital goods of which the world was so sorely in need, and that any currency which was freely convertible into U.S. dollars would at once undergo that conversion so as to give the holders immediate dollar purchasing power. This would provide the outlet for American production which the

authorities there regarded as essential for the maintenance of a stable internal economy and for the prevention of mass unemployment. This condition was to be fulfilled by this country within one year from the effective date of the Agreement unless, in exceptional circumstances, the United States agreed to its postponement to a later date.

The next condition was directed towards the same objective, and provided that within one year from the effective date of the Agreement (unless the United States consented to a postponement): (*a*) the United Kingdom would impose no restrictions on the payment for permitted imports of United States products or for other current transactions between the two countries or on the use of sterling balances due to United States residents as a result of current transactions; and (*b*) to impose no restrictions on payments and transfers for current transactions.

The second part of this condition was, of course, the most onerous. It obliged this country within a comparatively short period to shoulder the responsibility *for the conversion into dollars of its entire adverse trade balance with the rest of the world.* It must have been evident that the total amount available under the line of credit would have been barely sufficient to cover the deficit over the ensuing four years of our trading and financial transactions with the United States alone, and it is indeed hard to understand why, with a prospective world deficit over the next four years of at least £1,500 millions, we should have accepted an obligation to be responsible for the conversion of this entire sum into dollars with an available reserve of the £940 millions of the credit line, together with what we could spare from our own existing gold and dollar reserves, and any small additions to these reserves which might accrue to us. The efforts made to comply with this part of the condition are described later.

The third condition is what is known as the "discrimination clause." This provides that if either country imposes or maintains quantitative import restrictions, such restrictions shall be administered on a basis which does not discriminate

against imports from the other country in respect of any products. This means that we can only switch our buying from America of any commodity produced in that country to purchases of similar products from any other country with American consent. In other words, if we are so short of dollars that we cannot afford to buy Florida grapefruit, we must not buy them from South Africa or Palestine, but must go without them entirely. The only alternative is for us to buy quantities of the product from each producer reduced in equal ratio so that each seller suffers proportionately, and we have to submit to a considerable reduction in our general supply of this article of diet. This provision has, in fact, already been enforced in several cases by the United States though, in fairness, it must be recorded that they have been equally generous in allowing us to change our sources of supply in the case of certain commodities, notably tobacco.

A final condition in regard to the eventual complete convertibility of sterling provides that the United Kingdom shall take early steps to deal with the idle (or " frozen ") accumulated sterling balances of other countries. A settlement with each such country is to be made on terms which allow for the immediate release of a proportion of any such balances, and that the amount so released *shall be immediately convertible into any other currency for current transactions*, while the remainder of all such balances shall be similarly released and made convertible over a period of years beginning in 1951, unless any part of such balances is cancelled under agreement with the country concerned as its contribution to our war effort. Further comments on the working of this clause are given later. Minor conditions were that the line of credit should not be used to discharge existing obligations of this country to third countries, and that this country would not arrange any long-term loans from Governments within the British Commonwealth on terms more favourable to the lender than the terms of the line of credit until after 1951.

It is now clear that the estimates of our adverse international balances for the next four years submitted by our representatives

during the negotiations for the line of credit were miscalculated by a wide margin. Certainly events moved far less favourably than had been anticipated both politically and economically, but the misgivings expressed by certain prominent Members of the House of Commons when the Agreement was laid before it for approval have proved to be amply justified. The Agreement was actually signed in Washington on 6th December, 1945, subject to ratification by the Legislatures of both countries, but this country was required to complete its ratification by 31st December, 1945, *i.e.*, in just over three weeks, whereas the American Legislature took until 14th July, 1946, to complete its ratification. The effective date of the Agreement was, therefore, 15th July, 1946, and as from that date we had command over dollars to a value of about £940 millions to meet what would have been, had the Agreement been fully implemented, a world deficit of dollars from that date to 31st December, 1951. In point of fact, the essential needs of this country and other Sterling Area countries for American products, required a much greater sum in dollars than had been estimated, particularly in view of the steep rise in American internal prices which was taking and continued to take place, and quite apart from the enormous drain on our dollar resources which took place immediately we endeavoured to carry out our obligation to make sterling a fully convertible currency. A summary of our attempts to carry out this latter obligation is given in the following chapter. A further unforeseen factor was the severe weather of the early part of 1947, which caused a fuel crisis and a very serious slowing down of production in this country. For a variety of reasons, therefore, the rate of use of the dollar credit was very much greater than had been planned for, and although drawings did not commence until 15th July, 1946, nine-tenths of the total sum had been used by 20th August, 1947. According to official estimates in 1945, our international trading deficit, which was then running at the rate of about £60 millions per month, would be reduced to an average of about £35 millions per month during 1947, and to

a little over £20 millions per month in 1948, while the deficit was expected practically to disappear by 1950. In the event, however, the deficit increased during 1947 instead of diminishing, and the requirements of the other countries of the Sterling Area for dollar exchange also increased slightly instead of diminishing appreciably. A rough analysis of drawings and expenditure shows that within just over thirteen months, drawings under the credit totalled £840 millions, leaving only £100 millions available out of the original total which was expected to last for four and a half years. Out of these drawings an amount of £650 millions had to be used to meet the net direct deficit (including dollar expenditure in the British zone of Germany) of the United Kingdom with countries of the Western Hemisphere, mainly, of course, the United States. A further sum of £90 millions was needed to cover the net deficit of all the other countries of the Sterling Area with the Western Hemisphere. The brief period during which sterling was restored to an almost internationally convertible basis resulted in our having to provide dollars to the tune of a further £100 millions. At this stage the Agreement was suspended in so far as further drawings under the credit were concerned, but it remains to be seen whether we are still expected to carry out our repayment obligations after the end of 1951. After some little time, the balance of £100 millions of the credit, which had been "frozen" by the American authorities on the suspension of certain of our obligations under the Agreement, was released to us and was used fairly rapidly to cover current trading deficits with the Western Hemisphere so that the credit is now entirely exhausted.

The relative American legislation which first authorized Lease-Lend and its continuance, and eventually its applicability both ways, also provided that from the American side it should come to an end within twelve months from the actual cessation of hostilities. Consequently, in August, 1946, one year from the date of the final Japanese surrender, the Lease-Lend powers of the American administration automatically lapsed and the arrangement came to an end. At the time of

negotiating the Anglo-American Loan Agreement the two parties also came to an agreement regarding settlement for Lease-Lend reciprocal aid, surplus war property, and claims. Subject to certain financial adjustments it was agreed that a net sum of £650 millions was due from the United Kingdom to the United States, of which $118 millions covered the difference between services and supplies rendered by the one country to the other, and $532 millions covered all other items, including surplus property, *i.e.*, war stores, etc., and all United States interests in installations owned by them in the United Kingdom. Of this agreed total debt the United Kingdom has undertaken to place at the disposal of the United States in sterling an aggregate dollar value of up to $50 millions at current exchange rates during the period to 31st December, 1951. The United States will use this sterling exclusively to acquire land or to acquire or construct buildings in the United Kingdom and the Colonial Dependencies for United States use, and for carrying out any agreed educational programmes. Any balance will be settled on the same terms as those laid down for the Credit Line.

These settlements do not carry into effect the formula of equal distribution amongst the United Nations of the money costs of the war as laid down by President Roosevelt in 1942, and reaffirmed by President Truman in August, 1945. The basic principle was that each country should contribute to a common pool a common percentage of its national income, and each country would then be entitled to draw from the pool its actual cost in money of its war effort. This principle is obviously just and equitable, but mathematically the final result is amazing, as seen on pages 143 and 144.

In any event, experience has shown that not only was the financial provision entirely inadequate, but the economic effects of certain of the conditions on which America insisted were completely opposite to those which it was intended should be produced. America demanded through the International Monetary Fund a system of rigid exchange rates, but at the same time required us to make sterling internationally

convertible. This completely stopped the "natural" control over exchange rates produced by the factors of supply and demand from operating. The "non-discrimination" clause was intended to maintain American export markets. In effect and owing to her concept of exports as a mere means of disposing of surplus production instead of acting as a means of providing purchasing power for imports, this demand proved entirely constrictive, as lack of dollar purchasing power forced us to curtail dollar imports with a resulting proportionate curtailment of similar imports from other countries, resulting in a general reduction of world trade. Finally, the demand for the scaling down, release, or funding, of "frozen" sterling balances, meant that every release caused a still further inflation of already inflated sterling purchasing power and saddled us with unrequited exports. At the same time, the extra sterling purchasing power deluded buyers into paying higher prices than those ruling in scarce-currency areas and lulled sellers into a sense of false security.

There is a clear-cut distinction between "blocked" and "frozen" sterling. The term "blocked" is applied only to liquid sterling funds held in the United Kingdom for accounts of residents of countries outside the scheduled territories, and which by a ruling of H.M. Treasury are not allowed to be transferred out of the country, but are eligible only for investment in specified securities. Such balances can arise from the voluntary realization of certain types of capital investment in this country, or from sterling balances of emigrants from this country in excess of such sum as they may be allowed to have transferred to them in their new country of residence, or from sundry other sources as may be ruled by the Treasury. Such funds are indeed "blocked" against the owner in that he can only switch from an investment of any one type to another of a similar type, while liquid funds against which a blocking ruling has been issued must either remain liquid or can be invested only in British Government securities carrying a redemption date of not less than ten years from the date of purchase. In all cases, however, any income earned by

"blocked" funds or investments is at present free for transfer through normal banking channels to the owner in his country of permanent residence.

"Frozen" sterling, on the other hand, originated as an accumulation of sterling by any other country (including countries in the Sterling Group) owing to receipts from their sales to us of goods and services exceeding, to a greater or lesser extent, their expenditure on purchases of goods and services from us. During the last war, when the main weight of our productive capacity was centred on war production and our Mercantile Marine was almost wholely occupied with the task of fetching and carrying war supplies, the volume of our production available for export and our capacity for rendering commercial services was reduced almost to vanishing point. At the same time, our requirements in the shape of imports into this country and of local supplies for our forces overseas for war purposes were enormous. As a result, the principal supplying countries were steadily being credited with large amounts of sterling which the owners were forced to leave lying idle because neither we nor any other country of the sterling group could offer goods or services of which the holders of sterling were in need or were prepared to purchase (owing to the universal concentration on war production), and because we had not the external resources in gold and exchange to allow such sterling to be converted into the currency of some country outside the Sterling Group from which the owners of the sterling could have purchased the goods and services which they actually required. During the war years such sterling balances tended to become concentrated in the sterling accounts of the various Central Banks of the holding countries, and to a much lesser extent in the sterling accounts of the commercial banks of those countries. Even before the end of the war, however, it became apparent that the economy and productive capacity of this country would be quite inadequate to redeem these accumulated balances by taking them in exchange for current production of goods and services, even over a period of years, because our own current needs,

combined with the almost total exhaustion of our external resources, imperatively demanded that our maximum current production should be devoted towards providing the means of payment. We simply could not afford to spare any of our current production as an unrequited export in extinguishment of old debts. The Treasury was, therefore, obliged to announce to each of the countries concerned that its sterling balances in excess of a stated sum, which was to remain freely usable as a working balance, must be regarded as "frozen" and as completely unusable until mutually satisfactory arrangements for their release could be made. Apart from certain preliminary discussions with certain Sterling Area countries regarding the size of the sums required to be made freely available for use as working balances, and some tentative inquiries as to the extent to which such countries might be prepared to write off altogether a part of their total balance as an additional contribution towards the intense war effort of this country, the first formal arrangement for the disposal of "frozen" sterling was made with the Argentine in February, 1947. This was in conformity with that part of the Anglo-American Loan Agreement which required this country to arrange for the releasing, funding, or writing off of "frozen" sterling balances as soon as might be practicable.

The Agreement with the Argentine was quite exceptional, in that it provided for the release of almost the entire amount held by the Argentine on "frozen" account, but it was not an actual release of cash which the Argentine could use as it pleased. The railway system in the Argentine was originally developed and financed by British capital, and had formed a very useful source of overseas income in that, in spite of various defaults, interest at the rate of about £5 millions per annum accrued to this country. The Argentine Government, however, had for some long time past, been anxious to acquire and nationalize the internal railway system of the country and seized the opportunity to carry this into effect. The basis of the agreement was that the Argentine Government should buy out all British interests in her railways for a sum of £150

millions. To provide this purchase money, it was agreed that a sum of £125 millions should be released from Argentine "frozen" balances, which left only a comparatively small amount on these accounts. The balance of £25 millions of the purchase money was to be paid out of current balances accruing to the Argentine out of normal trading and financial operations. Thus an overseas asset worth £5 millions per annum to this country had to be sold outright in order to mop up a debt which had arisen from our wartime purchases from the Argentine in the furtherance of our struggle to keep the war away from the Americas. The transaction was eventually carried through, and the various British shareholders received cash payments in exchange for the surrender of their shares. This was undoubtedly inflationary in its effects, as cash which had previously been immobilized passed into the hands of a number of residents of this country, who were then free either to re-invest it or to spend it in any way they chose.

This initial Agreement, however, did not appear to set a precedent, and in the case of Brazil, and also of Uruguay, only provisional agreements were entered into under which a few millions sterling were released annually while the major portion of the "frozen" balances were to be utilized for the purchase of British-owned undertakings in the two countries, subject to definite agreements for such a purpose being concluded. Ceylon, on being granted Dominion status, was allowed to draw a few millions from her "frozen" balances under a temporary agreement, and even up to the time of writing, no final settlement with any of the main creditor countries other than the Argentine has been attempted, but certain releases have taken place under agreements running from year to year. It must be appreciated that all sums released from "frozen" balances for use in current trading and financial transactions must result in what are called "unrequited" exports as the released funds are used to pay for goods and services out of the current production of the Sterling Area which would otherwise produce immediately new purchasing power, whereas they are in effect paid for

out of old debt due in respect of goods and services which we have long since received and utilized.

In pursuance of our obligations under the Anglo-American Loan Agreement, and having dealt with our main creditors outside the British Commonwealth and Empire, we then proceeded to discuss the " frozen " balances of other countries included in the Sterling Area Group. Canada, Australia, and New Zealand had already made most generous gestures by making gifts to this country out of their accumulated sterling balances; in other words, they had scaled down our wartime debts to them as was envisaged during the Anglo-American negotiations. India and Egypt, however, proved more obdurate and flatly refused to consider any such scaling down, although in these two instances in particular the accumulated debts were almost entirely due to the cost of the local upkeep of the large British forces which were devoted to the protection and defence of these two countries. During the early part of 1947, prolonged negotiations took place and temporary Agreements were reached at the end of June, 1947. In the case of India, whose " frozen " balances amounted to about £1,160 millions, we had to agree to release immediately £67½ millions for use by India, which not only could be used to make payments within the Sterling Area, but which *could be converted into any other currencies* at the option of the India Government. This burden on our current resources in gold and " hard " currencies was of course assumed under our obligation to America to make sterling freely convertible as far as possible by 15th July, 1947. With the severance of Pakistan from India it was eventually agreed between these two Dominions that Pakistan should be given a certain share in the sum thus released by this country. These arrangements lasted for twelve months, and in July, 1948, a further sum of £40 millions was released to India in respect of the year 1948-49, while another £40 millions was to be released for the year 1947-50. Neither of these two releases was, however, to be convertible into any other currency as attempts to make sterling internationally convertible had broken down in the

meantime, so that these sums were available to India for use only within the Sterling Area, and her requirements in "hard" currencies were left to be met out of her allocation from the Sterling Area "pool," supplemented by such foreign exchange as she herself acquired outside the "pool." At the same time, a further agreement with Pakistan was entered into separately under which, out of her share of the original India "frozen" balances of about £100 millions, a sum of £10 millions was released for use during 1948-49 in the Sterling Area only, but a further sum of £5 millions was allocated to her in "hard" currencies.

Also, in June, 1947, a temporary agreement was reached with Egypt, whose "frozen" balances amounted to about £400 millions. Of this total an amount of £20 millions was released for current requirements in sterling, but this was not eligible for conversion into "hard" currencies, as Egypt had been allocated a sum of $60 millions from the Sterling Area "pool" for that year, as against an amount of $10 millions only which it was anticipated she would be able to contribute to that "pool." In addition, further sums were released from the "frozen" balances to provide for payment in respect of British war stores in Egypt purchased by the Egyptian Government, and for the possible purchase by that Government of a section of the Palestine railway and other British interests. The question of further annual releases was left for future discussion.

An Agreement with Iraq, whose "frozen" balances amounted to about £60 millions, was also reached in June, 1947, under which the sum of £15 millions was released for use over the ensuing twelve months, and a further £11 millions was to be released over the following four years. As in the case of the first releases to India, all these releases from the Iraq "frozen" balances were eligible for use either in making payments within the Sterling Area or for conversion into "hard" curencies at the option of the Iraq Government.

It is evident that the British Government did its utmost to comply to the fullest extent with the obligations which it had

assumed under the Anglo-American Loan Agreement, and which required it to make sterling internationally convertible, and to take steps to scale down, release and/or fund the currently immobilized sterling balances accumulated by other countries as a result of the war. It must be repeated, however, that either our negotiators were too sanguine or the Americans too hard bargainers, as a loan of roughly £1,000 millions in dollars was obviously inadequate to meet both our current trade deficit of at least £600 millions per annum, and any appreciable releases from "frozen" balances totalling about £3,500 millions. Small wonder that our gallant attempt to make sterling generally convertible met with speedy and complete failure, but the cost of that attempt in the shape of the repayment of the loan, plus interest, still has to be faced.

As was stated earlier in this chapter, another major condition of the Anglo-American Loan Agreement was that this country should impose no restrictions on the use of sterling for payments and transfers for current transactions either with residents of the United States or of any other country; in other words, sterling was to be made convertible into any other currency, including U.S. dollars, on demand. Unless the United States agreed otherwise, this state of international convertibility had to be in operation by 15th July, 1947, and early in that year the first steps towards this objective were taken by the introduction of the "Transferable Sterling Account System." This new type of sterling complied exactly with its title in that it could be transferred freely and without formality between residents of the countries admitted to the System and who were empowered by their own authorities to maintain Transferable Sterling Accounts. At the end of February, 1947, it was officially announced that a transferable type of sterling was to be introduced and would be applied to the Argentine, the Belgian Monetary Area, Canada and Newfoundland, the Dutch Monetary Area, and the Portuguese Monetary Area. In the case of the Argentine, all former Argentine Special Accounts automatically became Argentine Transferable Sterling Accounts, but in the case of the other

areas admitted to the System, the local authorities in each case appointed only certain of their banks and financial houses as authorized to maintain Transferable Sterling Accounts. Belgium in particular allowed only the Banque Nationale de Belgique to maintain such an account. As soon as these transferable accounts were established, transfers of sterling from any one transferable account to another could be made without any formality whatever, except that the receiving banker who was asked to credit sterling to a transferable account required the cheque or draft by which the payment was made to be marked, "Funds emanate from a . . . Transferable Sterling Account," or some similar phrase to show the type of transferable account from which the funds were being drawn. In addition, the most important attribute of the new type of sterling was that it could be transferred freely to or from an American Sterling Account; thus, as American sterling could either be created by the sale of dollars to the British Exchange Control or could be converted into dollars by the sale to that Control of sterling from an American account, transferable sterling became, in effect, synonymous with American sterling, and so with American dollars.

In due course other countries were admitted to the Transferable Account System as fast as the necessary special agreements providing adequate safeguards could be concluded, and as follows:

Italy: 21st April, 1947; Brazil, 2nd June, 1947; Norway and Spain, 1st July, 1947; Czechoslovakia and Finland, 9th July, 1947; Egypt, the Sudan, Ethiopia, Sweden, Iran and Uruguay, 15th July, 1947.

Subsequently, Poland, Siam and the U.S.S.R. were admitted to the System in March, 1948, and Chile in July, 1948. In the case of the earlier admittances up to 15th July, 1947, all former Uruguayan Special Accounts and all sterling accounts of residents of Ethiopia and Iran became transferable accounts, but in all other cases only certain banks and financial houses were authorized by their own authorities to maintain transferable accounts. Also, on the 15th July, 1947, the

Special Sterling Account System was brought practically to an end as Bolivia, Chile and Peru were taken out of the Special Account System and placed with the American Monetary Area, so that the sterling accounts of residents of these three countries became American sterling accounts, and so convertible on demand into U.S. dollars.

It may be opportune here to comment on the subsequent effects of placing Bolivia, Chile and Peru in the American Monetary Area. When we were reduced to " scraping the bottom of the barrel " for dollars, we were forced to curtail drastically our imports from all those countries for whom sterling payments were representing a dollar cost to us. In consequence, and in the course of only a few months, Chile and Peru found themselves so short of sterling that they in turn were compelled drastically to curtail their imports from the Sterling Area, including even goods and raw materials essential to their internal economies. As a result it became urgently necessary to take steps to revive two-way trade in both cases and, as stated above, Chile was taken out of the American Monetary Area and admitted to the Transferable Account System in July, 1948, while in August, 1948, a special bilateral agreement was concluded with Peru under which, while she was given her own bilateral type of sterling for use ordinarily only between Peru and the Sterling Area, this country agreed to facilitate in every way possible the use of sterling for transactions between Peru and other foreign countries, thus making Peru a kind of associate member of the Transferable Sterling Account System.

As was only to be expected, all surplus sterling in the possession of the members of the Transferable Sterling Account System gravitated to the United States by transfers to American sterling accounts, from whence it was almost immediately converted into U.S. dollars. Our estimated net adverse balance of payments with the Western Hemisphere had been running at the rate of about £600 millions per annum, while the rest of the countries of the Sterling Area had a similar net adverse balance of about £90 millions per annum. Out of

the original American Loan of about £940 millions which first became available on 15th July, 1946, an amount of nearly £700 millions had therefore been used to meet these deficits by 15th July, 1947, by which date sterling had to be made freely convertible. As is shown above, this international convertibility was effected, except for fourteen countries who were not themselves ready to join the Transferable Account System, and who the United States agreed should be left for subsequent consideration. We had, however, shouldered the dollar liabilities of the greater part of the world while still creating every month sterling debts to other countries, which the state of our industry and economy prevented them from using in the immediate purchase from us of goods and services which they urgently required. America, with her productive system geared to a higher pitch than ever before, and, to a lesser degree, Belgium with her industries preserved and kept in good order during the German occupation, could offer delivery in a matter of weeks of capital goods and basic materials of which we could offer delivery only after many months. In consequence, every country with surplus transferable sterling used it in making purchases from either the United States or Belgium, and the latter country lost no time in converting its own surplus transferable sterling into dollars. The experiment launched so bravely on 15th July, 1947, lasted only until 21st August, 1947. During this time the current deficits of this country and the rest of the Sterling Area combined with the conversion of transferable sterling into dollars absorbed the equivalent of roughly £265 millions out of the remainder of the dollar loan, leaving only the equivalent of £100 millions available out of the £940 millions placed at our disposal a little more than thirteen months earlier and intended to last for four years. No one abroad had any confidence in sterling, and the Continent in particular retained vivid memories of successive doses of currency devaluation. There was a widespread fear of a devaluation of sterling in view of our constantly increasing international indebtedness, and no one was prepared to hold our currency, so if it could not be

spent immediately, every opportunity was taken of changing it for something else. Not only was all available sterling eligible for conversion into dollars immediately so transformed, but foreign interests having future payments due to them in convertible sterling hastened to sell forward sterling against dollars, and our authorities had of course to earmark cover in the shape of dollars for such sales. The drain on our dollar resources during the six weeks of convertibility was even larger than that which took place prior to the suspension of gold payments in September, 1931, and our authorities did not hesitate to recognize their defeat, and on the 21st August, 1947, announced that the convertibility of sterling into American or Canadian dollars was suspended, and that all further payments from Transferable Sterling Accounts to American Sterling Accounts or Canadian or Newfoundland Sterling Accounts would be subject to permission from the Exchange Control which must be sought by application on the appropriate Exchange Control form. At the same time, Canada and Newfoundland were taken out of the Transferable Account System and given a bilateral type of sterling of their own, which was eligible for use only for transactions between those territories and the Sterling Area.

Although payments *from* transferable sterling accounts to American accounts became subject to official permission, a general authority to banks acting as sub-agents for the Bank of England was given almost immediately empowering them to allow transfers *from* American Sterling Accounts *to* Transferable Sterling Accounts. Payments between the remaining Transferable Sterling Accounts remained free from formality and unhindered, and this position still exists at the time of writing. Certain countries in this system, however, were still unwilling to accumulate sterling balances indefinitely, but found themselves being pressed to go on accepting transferable sterling in payment for goods and services which other members of the system wished to purchase from them. Again Belgium, with her exportable surplus of capital goods and basic materials, became overloaded with sterling, and in

September, 1947, she withdrew from the Transferable Account System and entered into a new Payments Agreement with this country under which sterling became eligible for use only for transactions between the Belgian Monetary Area and the Sterling Area, and not for transactions between Belgium and other countries, except by special consent of the three parties concerned. Further, Belgium agreed to retain £12 millions out of her existing sterling balances as a " working balance," and to hold up to a further £15 millions as a kind of credit to this country against our undertaking that we would convert all Belgian sterling balances in excess of this total of £27 millions into gold or dollars on demand. This in effect made Belgian sterling a " hard " currency, since she was still running a balance of payments adverse to the Sterling Area. A " hard " currency is one which is in short supply, *i.e.*, hard to obtain, whereas a " soft " currency is one which is in adequate or even excessive supply or, conversely, sterling of which another country is so short that it is regarded as a " hard " currency as far as the other country is concerned. Thus, American, Canadian, Argentine, Belgian and Swiss sterling all had to be regarded by us as " hard " because these countries were our creditors both on past and current account and (except for the special conditions prevailing between this country and America and Canada) they were unwilling to accumulate sterling in excess of certain levels, so that any further purchases we might make from them after these levels were reached would cost us gold or dollars. On the other hand, a country such as France, to whom we were selling much more than we were buying, mainly owing to the semi-luxury or even luxury nature of the products which she had available for export, became increasingly short of sterling so that for us to pay sterling to a French account was in effect only a cancellation of part of an outstanding debt, and such sterling was therefore regarded as " soft."

Further withdrawals from the Transferable Account System followed, and special bilateral agreements were concluded with Portugal in December, 1947, Italy in February, 1948,

Uruguay in March, 1948, and Argentine and Brazil in May, 1948. In each case the country concerned withdrew from the Transferable Account System and was given a special type of sterling of its own eligible for use only in transactions between that country and the Sterling Area. Any other transfers of sterling required the special permission of the three countries concerned. At the time of writing, the current types of sterling may be divided into five groups, and reference should now be made to the Chart and Memorandum which are reproduced, by permission of the owners of the copyright, as Appendices to this book. It should be noted that some form of agreement has in nearly every case been concluded between this country and the other country concerned. This applies even to the countries which are members of the Sterling Area, so that the use of sterling is almost universally the subject of a bilateral agreement with this country. The terms of these agreements differ materially in several respects, however, and in order to describe the type of sterling which is normally eligible *only* for use between the country concerned and the Sterling Area, the authors of the Chart have invented the expression " Bilateral sterling," even though practically every other type of sterling has been the subject of a bilateral Payments Agreement with the country concerned. The prospects of an extension of the *transferability* of sterling, at least in Western Europe, are discussed in the following chapter, but it seems most improbable that any further attempt to make sterling an international currency convertible on demand into any other currency, particularly currencies of the Western Hemisphere, will be made for a long time to come.

Concurrently with these external efforts to rectify and restore the international position of sterling, other steps had to be taken to provide the necessary legislative cover for such present actions and their probable repercussions. The entire basis of the Exchange and Trade Control system in this country was therefore overhauled and fresh legislation laid before Parliament in the latter part of 1946. The new proposals were duly passed into law under the title of the Exchange

Control Act, 1947, and the "appointed day" on which the provisions of this Act should enter into force was eventually fixed as 1st October, 1947.

From its inception, the Exchange Control in this country operated under powers conveyed under the series of Emergency Powers (Defence) Acts, which were subsequently renewed under the Supplies and Services (Transitional Powers) Act, 1945. Under these powers a large number of Statutory Rules and Orders was issued from time to time which had the force of law and which empowered the Treasury to lay down specific requirements. All the Statutory Rules and Orders and the various "Notices to Banks and Bankers" and other Notices to professional bodies or individuals, were, however, couched in sufficiently general terms as to allow adjustments and minor variations to be made administratively. A certain degree of flexibility was thus given which, so far from being abused by the authorities, operated to the general advantage in that a certain amount of tightening or loosening up of the Regulations could be applied all round as and when circumstances required or allowed of it. The signing of the Anglo-American Loan Agreement involved this country in new obligations, however, and new legislation became necessary. The opportunity was also taken to weed out some of the wartime requirements which were no longer needed, and to remove certain redundancies which unavoidably had crept into such a mass of Regulations and Notices over so long a period. Some new requirements, called for by post-war conditions, the trade revival, and our new international obligations, were also incorporated in the new Bill, which was eventually passed into law by Parliament as the Exchange Control Act, 1947. Under the provisions of the Act, it did not come into force as a whole immediately, but powers were given to the Treasury to announce "appointed days" for the coming into force of the various provisions. As and when an "appointed day" is announced, the necessary Statutory Rules and Orders are issued simultaneously, based on the relative clause or clauses of the Act and, owing to the abortive

attempt to render sterling internationally convertible, to which end many agreements with other countries were entered into, many more Standing Rules and Orders than was anticipated have had to be issued to cover the number of new agreements which have had to be arranged following the suspension of convertibility (see later). The Act is in six Parts, containing in all forty-four Clauses, and has six Schedules. Much of it codifies the Defence (Finance) Regulations, which it replaces, but the following is a brief summary of its provisions.

Part I. Gold and Foreign Currency. This covers the earlier Regulations requiring the declaration and surrender to the Treasury on demand of all gold and " specified " foreign currencies which any resident of the United Kingdom, who is not an " authorized dealer " is entitled to sell or procure the sale of. It allows the price of purchase to be fixed by the Treasury without right of appeal. It provides that certain documents such as travellers' cheques and letters of credit which are intended to enable the person to whom the document is issued to obtain foreign currency from some other person, shall be regarded as foreign currency for the purposes of the Act. It requires persons holding gold and foreign currencies in the form of notes as bailees to give notice to the Bank of England of such holdings, and gives the Treasury power to direct that such gold and foreign notes shall be kept at all times in the custody of a named banker, if they are not due for surrender to the Treasury under the Act. It also forbids any resident of the United Kingdom, other than an " authorized dealer," to buy or borrow or sell or lend any gold or foreign currency from or to any other person either in this country or abroad other than from or to an " authorized dealer." This makes it illegal for any person in this country to deal in any way in gold or foreign exchange except through the intermediary of one of the banks and financial houses who have been appointed " authorized dealers."

Part II. Payments. This forbids transactions or operations of three kinds: first, in this country, no payment may be made to or for the credit of a person resident outside the " Scheduled

Territories " (formerly called the " Sterling Area "), nor, on behalf or by order of such a person, may any payment be made to or for the credit of a person resident within the Scheduled Territories, nor may any sum be placed to the credit of a person resident outside the Scheduled Territories; second, no resident of the United Kingdom may make any payment outside the country to or for the credit of a person resident outside the Scheduled Territories; and, third, no resident of the United Kingdom may make any payment outside this country to or for the credit of a person resident within the Scheduled Territories as a result of which any person receives a payment outside the Scheduled Territories, or acquires property situated outside those Territories, or has transferred to him, or has created in his favour a right, whether present or future, and whether vested or contingent, to receive a payment or to acquire property outside those Territories. This makes illegal any form of " compensation " arrangement between residents and non-residents of the Sterling Area, and would even cover an arrangement under which the expenses of a visitor to this country from, say, the U.S.A., were met by a person resident here on the understanding that the person in question would subsequently visit the U.S.A. as the guest and at the expense of the American visitor. The formal existence of such an arrangement, however, would be very difficult for even the Treasury Solicitor to prove in most cases!

Part III. Securities. Under the provisions of this Section the existing restrictions and requirements underwent considerable changes. The power which the Treasury possessed under the former relative Regulations of calling for the registration with the Bank of England of certain specified securities and of vesting in itself, *i.e.*, requiring the compulsory sale to it at an arbitrarily fixed price any or all of such securities, was removed. There is now no compulsion on any United Kingdom resident to declare to the authorities his ownership of or interest in any security capable of being sold on a foreign market (except in the case of newly-acquired ownership of a majority interest in a foreign company), and " dollar " securities such

as Brazil Tractions, International Nickels, etc., which were formerly "restricted," may now be freely dealt in between United Kingdom residents. Power is taken, however, to require the immediate repatriation to this country of the proceeds of any such securities as are sold by a resident to a non-resident, and any such sale is at once brought to the notice of the authorities when the necessary Declarations are completed by or on behalf of the seller, and a Licence is applied for on behalf of the foreign purchaser, as must be done under the administrative requirements issued under the provisions of the Act. This Section imposes new restrictions on "bearer" securities, which may no longer be retained in the physical possession of any owner or his nominee, but must be deposited with an "Authorized Depositary" by whom they will be released only to another "Authorized Depositary" or to the Paying Agents for the issue where the securities are redeemed by the borrowers or have matured. Coupons relative to such securities and due for payment may also be released by the "Authorized Depositary" to the Paying Agent. Special administrative arrangements have been made to allow stockbrokers, solicitors and similar professional persons to hold such securities temporarily where necessary in the ordinary course of business, but the actual "Authorized Depositaries" are confined to banks and acceptance houses. Power is also taken to require a resident to furnish full information in regard to and even to control the policy of any non-resident concern in which he holds a controlling interest, and this provision covers also any group of residents who, between them, hold a majority interest in any non-resident concern. The object of this provision is, of course, to ensure that all profits and capital increments accruing abroad to residents of this country shall be brought home wherever the resident interest is large enough to enable instructions to this effect to be given and carried out, and so prevent the accumulation of funds abroad by residents through the non-distribution of profits or capital increments by non-resident concerns which they control, either as individuals or as a group. Capital

movements, except within the Scheduled Territories, continue to be strictly controlled under this section and, administratively, no transfers of capital abroad are at present permitted unless it is clear that the proposed investment will directly benefit the export trade of this country. The interest yield on an investment abroad is immaterial; it is solely an increase in, or at least the retention of, export trade in which the authorities are interested.

Part IV. Import and Export. This Section covers mainly the import and export of currency notes, Treasury bills, bills of exchange generally, promissory notes, securities, insurance policies and other documents of title (except bills of lading) and gold. Clause 23, however, gives power for the continuance of the previous control over the disposal of the sales proceeds of goods exported from this country to countries outside the Scheduled Territories as may be specified from time to time by the Treasury. This means that the Form C.D.3 procedure is perpetuated and may even be extended to additional countries should the Treasury think fit.

Part V. Miscellaneous. This Section continues several previous requirements in regard to certain somewhat intricate transactions. It requires residents to secure prompt payment of any money due to them by foreigners, to bring home the proceeds of exports, and to ensure the arrival of imports for which they have been permitted to make payment, within a stipulated time. It also requires that where permission has been given for a purchase to be made within the Scheduled Territories of goods for resale outside those Territories, the party concerned shall not allow any undue delay in effecting the resale or in his receiving payment for such resale. Further, it gives the Treasury power to order the sale of any property acquired in contravention of the Act, or as a result of refraining to offer any specified currency for sale in the required manner, and also to direct that in certain circumstances specific rights, goods, or property shall be vested in the Treasury. This Section also prohibits the transfer by a resident to a non-resident of any rights under any policy of assurance, except

by permission of the Treasury; this also applies to rights in any annuity or insurance granted under the Government Annuities Act, 1929. The Section also prohibits the settlement by a resident on a non-resident of any property or interest in any property otherwise than by Will except by permission of the Treasury. Finally, the Section lays down the duties of a resident or group of residents holding a majority or controlling interest in any foreign company. In such cases the Treasury can call for full particulars of the assets and business of the foreign company, and the holder or holders of the majority or controlling interest must see that any available gold or specified currency held by the foreign company is duly surrendered in the required manner, that dividends are declared and paid and any assets realized as may be directed by the Treasury, and that no action is taken by the foreign company in contravention of Treasury instructions. Further, where control of any body corporate is held by a resident or residents, such control may not be ceded to non-residents without Treasury permission, and lastly, the important provision that, except with Treasury permission, no resident may lend any money, Treasury bills, or securities, to any company resident within the Scheduled Territories but which is controlled either directly or indirectly by non-residents. This means, of course, that bankers must be quite satisfied that any company or body corporate that is ostensibly resident within the Scheduled Territories and to which they are asked to make loans or advances, is not in fact subject to the control of non-residents, either through a majority share holding or other controlling interest.

Part VI. Supplemental. This Section contains the important Clause 31 under which the Treasury is given power to grant exemptions, either absolute or conditional, from any of the other provisions of the Act. It also covers continuance of the previous system of blocked accounts where it is desired to prohibit the transfer to non-residents of any realization of capital, gifts by residents to non-residents, sterling assets of emigrants in excess of such sum as they have been allowed

officially to withdraw from this country, etc. It also contains a number of minor clauses in regard to contracts, legal proceedings, etc. (in which provision must always be made that, where necessary, the consent of the Treasury shall be obtained), and in regard to the mechanism for the enforcement and administration of the Act, the application of the Act to the Crown, *i.e.*, Government departments, etc., the making by the Treasury of Orders under the Act, and other powers of permission and direction by the Treasury, the provision of expenses for the administration of the Act, the application of the Act to a branch of any business, the authority of the Treasury to give directions as to the treatment to be accorded to persons leaving the Scheduled Territories, *e.g.*, emigrants, and directions as to the residential status of any person or the personal representative of a deceased person, and finally, definitions and interpretations of the terms used in the Act, the extension of the Act to Northern Ireland, the Isle of Man and the Channel Islands, by Order in Council, and the short title of the Act, its commencement by Treasury Order, the revocation of provisions of the Defence (Finance) Regulations, 1939, and the repeal of Section 11 of the Currency and Bank Notes Act, 1928, which empowered the Bank of England to require returns and sales of gold coin and bullion.

There are six Schedules to the Act which in fact amplify and extend the six parts of the Act. The First Schedule sets out the countries and territories included in the " Scheduled Territories " as at the time of coming into force of the Act. The Treasury has power at any time and without notice to add to or to subtract from the territories in this Schedule. The Second Schedule defines precisely what the Act regards as " Foreign Companies," while the Third Schedule does the same for blocked accounts, the Fourth for legal proceedings, the Fifth for the general enforcement of the Act and the penalties for offence, together with a series of definitions and provisions regarding " import and export," and the Sixth sets out the type of Order which may be issued by the Treasury without first requiring to be laid before Parliament.

As was stated above, the Act was brought into operation as from 1st October, 1947, by Treasury Order, and at the same time a fresh set of Statutory Rules and Orders accompanied by new notices to banks and bankers, company registrars, etc., were issued to introduce the new provisions and to perpetuate the old. Apart from the important changes in regard to certain types of securities and the minor alterations already mentioned, the business of Exchange Control continued without interruption or disturbance. The system of administering the Act by Treasury Order gives a welcome degree of flexibility, and the mounting experience of the Treasury and the Bank of England has led to the Act being operated with the minimum of friction and the least possible burden on the commercial community. Effect is also given to the provisions of new Trade and Payments Agreements by means of Treasury Orders, but in nearly every case any Treasury Order is so worded as to give a reasonable latitude to the Bank of England in its actual administrative practice under the Order. Such a degree of latitude is essential in view of the constantly changing conditions of world trade and finance, and the fluid state of current balances of payments between this country and others. Reference has already been made to the fact that certain international transfers of sterling may be made under the Open General Authority, whereas others require a special application on each occasion, and the nature of the decision given in each case will vary with the current state of the sterling balances of the other two countries concerned. Undoubtedly it will be to the interest of the authorities, as well as to that of the commercial community, for additional Open General Authorities for international transfers of sterling to be granted to as wide an extent as possible, and this is borne out by the concessions made by this country in regard to inter-European payments, which are dealt with in the following chapter. Finally, it should be mentioned that there is ample evidence to show that the authorities are always concerned with the interests of the commercial community and take every opportunity of easing the burden necessarily imposed by the

emergency need for Exchange and Trade Control. One instance of several relaxations in administrative practice is shown by the change of attitude towards the holding of stocks of goods abroad. One of the early principles of Exchange Control was that no payment for goods purchased from a foreign country would be allowed unless it could be shown that the goods were being imported into the Sterling Area either under Open General Licence or under a specific import licence, or that they had already been resold to some other foreign country from whom the authorities were prepared to accept payment in the approved method of reimbursement of the amount to be paid to the first foreign country. This requirement was directed towards the prevention of the export of capital either in payment for goods which were not in fact purchased or by purchasing goods and leaving them in storage abroad, and to the prevention of speculation in goods by a purchase in advance of sale. With the strenuous efforts to revive international trade after the conclusion of hostilities, approaches were made to the Government by various representative training bodies, such as the grain, coffee, and rubber trades, for facilities to be given for the restoration of at least some normal pre-war market practices. Special arrangements were eventually made in respect of these and other similar markets, and shortly afterwards it became apparent that the authorities were prepared to give sympathetic consideration to applications by merchants for permission to buy goods in the normal course of their business to be held temporarily as stock for eventual resale. For example, a textile merchant might require to have certain piece goods manufactured for him in France, knowing from his experience that the eventual material would find a ready market elsewhere, but being unable to secure firm buying orders until he could display sample cuttings, which of course he would be unable to do until the material was finished. If the Authorities were satisfied with the bona fides of the case they would allow the merchant to contract and pay for the manufacture of the piece goods subject to his undertaking that the finished material

would be sold in one or some of certain specified countries within a stated time. The same principle was applied to many other forms of entrepôt trade, and it may be stated in general that no genuine application will be refused by the Authorities unless its results would definitely be adverse to the interests of this country, such as where a merchant applied to purchase Brazilian cotton for " hard " sterling and resell it to China for " soft " sterling.

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CHAPTER 11

The European Recovery Plan—Regional groups in Europe—Inter-European trade and convertibility of currencies—The International Trade Organization and the Geneva and Havana Conferences.

TOWARDS the end of the 1939-1945 war, and as the various occupied countries were liberated, arrangements were immediately set on foot to restore as quickly as possible the ravages which war had inflicted on the economies and equipment of those countries. An international body was formed known as U.N.R.R.A. (United Nations Recovery and Rehabilitation Administration), which was financed mainly by the United States, but also to no small extent by this country. The funds so provided were used in the purchase of immediate essentials such as foodstuffs, clothing, etc., and road-making machinery, bridge-building equipment and materials, lorries, building materials and the like, with the object of restoring some semblance of normal life to the liberated peoples. Political history would be out of place in a technical book such as this, but it must be mentioned in passing that divergencies between Russia and her sphere of influence in neighbouring countries, on the one hand, and the remaining countries of Europe and all those other countries which had supported their cause, on the other, increased steadily and with growing rapidity. The world-wide clash of political ideologies was viewed with the utmost seriousness by the United States, and her Government

gave immediate consideration to possible measures for the preservation of Western ideas of democracy. As an official body, U.N.R.R.A. had been administered by a corps of officials which in fact formed an adjunct to the liberating armies, but as these armies were withdrawn from the various territories it was obvious that the continued presence of U.N.R.R.A. officials was likely to be regarded as an infringement of the sovereignty of the countries concerned. Direct American assistance had been given to this country by the Anglo-American Loan, but few, if any, other countries were in a position to shoulder the burden which such a loan would ultimately impose. American public opinion would not accept a revival of Lease-Lend arrangements, and some new method of assistance had therefore to be evolved.

In June, 1947, Mr. Marshall, United States Secretary of State, made a speech at Harvard University in which he suggested that if the war-ravaged countries of Europe could combine in a plan for mutual help towards general economic recovery, the United States might be prepared to give the necessary initial impetus to such a Plan on an extensive scale. Within nine months the outlines of such a joint Plan had been agreed upon, the necessary legislation had been laid before American Congress, and aid in the form of foodstuffs and raw materials was already commencing to flow across the Atlantic. Even though the original proposals were somewhat whittled down by Congress, the American nation committed itself to supply goods and cash to a total value of £1,263,750,000 during the fifteen months from the end of March, 1948, to the end of June, 1949. Not only might the repercussions of such a huge volume of unrequited exports have unforeseen effects on the internal economies of the countries concerned, but the methods by which such a volume of trade was to be conducted were of vital interest to the trading community in general. Also the plans for self-help between the beneficiary countries entailed entirely new departures from orthodox finance and trade, and the whole subject was, therefore, one which had to be studied carefully by every business man.

The authority for the expenditure of so much of the American taxpayers' money was conveyed under the Foreign Assistance Act of 1948, and the following is a brief summary of the objects, methods and machinery which it covered.

(1) It was designed to assist in the rehabilitation of sixteen war-damaged countries, including, as separate entities, the Anglo-American and the French zones of Germany and Trieste. None of the countries directly under Russian influence was included in the list, and the American Government announced that assistance would at once be stopped to any country which adopted a Communist Government. Switzerland, Portugal and Eire were included in part of the Plan, but only as borrowers and not as recipients of free grants.

(2) Assistance to the sixteen chief participants was mainly in the form of free grants, but the American law required that a minimum of 25 per cent. of the dollar aid allocated to any participant should be taken in the form of a loan bearing interest and repayable over thirty years.

(3) The bulk of the free grants were made in the form of foodstuffs, basic materials and capital equipment, but a certain proportion was provided in actual cash, which was allowed to be used for making "off-shore" purchases in countries other than the U.S.A. All such proposed purchases, however, had to be approved by the American authorities in respect not only of the goods to be purchased and the proposed country of supply, but also as to the price to be paid, and approval would be withheld if any proposed price was higher than that at which the same, or similar, goods could be obtained in the U.S.A. As regards assistance granted in the form of loans, the American authorities did not expressly require to approve the type of purchases made out of loan proceeds, nor the sources from which such supplies would be obtained, but the borrowers gave an informal undertaking that loan money should be spent mainly on goods of a capital nature and not on the type of consumer goods which were being supplied under the free grants.

(4) Each recipient country was required to enter into a

bilateral agreement with the United States, undertaking to conform strictly to the requirements of the " Foreign Assistance Act, 1948," to co-operate to the full with the American authorities in the administration of the Act, to use their utmost efforts to secure a balanced budget and a stable internal economy, and to adopt " realistic " exchange rates for their currencies in terms of others, and finally to join together in a plan for mutual co-operation to attain the maximum of inter-European economic unity and development of trade. Loans were the subject of separate agreements between the borrowing Government and the Export-Import Bank of the U.S.A., and followed more or less the normal type of such agreements, except that somewhat indefinite provision was made for the suspension of interest and capital payments by mutual agreement between the parties, should the borrower be able to demonstrate his inability to pay to the satisfaction of the lender.

(5) As a result of the bilateral agreements into which the participating countries entered with the U.S.A., each of them prepared and submitted to a Central Organization in Paris its own four-year plan for recovery and development, showing its minimum import needs and maximum export potential over that period. These plans were then " screened " by the Central Organization and co-ordinated into a European four-year master plan. This involved a number of bilateral trade and payments agreements between the participants and a scheme for the extension of credits by the leading creditor to the debtor countries, which is dealt with in subsequent paragraphs.

(6) The whole plan was known as the European Recovery Programme (E.R.P.) and was supervised by the Economic Co-operation Administration (E.C.A.), centred in Washington, but with supervising Missions in each of the participating countries. The Central Organization in Paris was known as the Organization for European Economic Co-operation (O.E.E.C.). The glossary of the principal bodies with their functions and other terms applying to E.R.P. procedure will be found as an appendix at the end of this book. Briefly, the

working of the Programme consisted, first, in the submission by the participants to the O.E.E.C. of detailed statements showing their minimum requirements in essential imports, the approximate cost and the sources from which they proposed to obtain such supplies, and this was first " screened " by the O.E.E.C. and finally approved by the E.C.A. This approval resulted in the allocation of a specified sum in U.S. dollars to the participant concerned for expenditure over a stated period. Next, each participant applied to the O.E.E.C. for permission actually to spend a portion of its allocation as and when the need to make purchases arose, and if the O.E.E.C. approved the application was passed to the E.C.A. which, if it also approved, would issue its authorization for the expenditure of the desired amount on the purchase of specified goods from specified sources. The participant country, having obtained its " authorization," was then at liberty to proceed to make the approved purchase for which it could pay either out of its own reserves of gold and foreign exchange, for subsequent reimbursement by the E.C.A., or it could request the E.C.A. to issue a " Letter of Commitment " addressed to a named supplier or suppliers in favour of the participant Government or its nominees, and undertaking to effect payment to the supplier or suppliers concerned as soon as the specified goods were delivered. Careful precautions were taken to prevent any leakage or misuse of E.R.P. funds, and all shipments had to be specially marked and documented. It was also a condition imposed by the Foreign Assistance Act that at least 50 per cent. of all goods obtained under E.R.P. should be carried in American bottoms, for which dollar freights would have to be paid out of the relative E.R.P. allocation.

Where a country itself financed temporarily its E.R.P. purchases, the E.C.A. would reimburse it in due course and on satisfactory documentation of the receipt of the goods, by paying over cash in dollars to the account of the foreign Government concerned. The entire system consisted, therefore, of the submission and approval of purchasing programmes,

the allocation of E.R.P. dollars, the authorization of the actual expenditure of such dollars and then either the issue by E.C.A. of a Letter of Commitment guaranteeing payment to the suppliers or the eventual reimbursement by the E.C.A. of dollars temporarily provided by a participant out of its own resources. Considering the colossal nature of the operation, these arrangements worked surprisingly well, and the supervision by the E.C.A. Missions appears to have been carried out with the maximum degree of efficiency and the minimum of interference with the internal affairs of participant countries.

(7) The free distribution of goods to a value of over five billions of dollars over a few months would of course have had a very serious inflationary effect on the internal economies of the recipient countries if no counter-measures had been taken. The receipt of, say, ten million bushels of wheat free of cost, which could result in the sale of bread at a price containing only milling and manufacturing costs, would have left the difference between this price and the normal selling price, including the cost of the wheat, in the hands of the public as additional spending power without any increase in the volume of purchasable goods to absorb it. Consequently, one of the conditions included in the bilateral agreements between the participating countries and the U.S.A. was that all goods received under E.R.P. should be sold within the recipient country through normal channels at current prices, and that the local currency so received by the Government concerned should be placed to the credit of a Special Account with that country's Central Bank or other approved financial institution. This meant that a Government receiving, say, ten million bushels of wheat free of cost would sell that wheat in the ordinary way to the trade against payment in local currency, and would thus withdraw that amount of purchasing power from circulation in the same way as would have happened had the trade conducted a normal transaction of using local currency to buy dollars with which to buy the wheat. These Special Accounts were also subject to E.C.A. supervision and

could not be drawn upon without its consent. The bilateral agreements provided that a maximum of 5 per cent. of funds standing to the credit of such accounts could be used by the E.C.A. for making purchases of basic commodities such as rubber, tin, copper, etc., within the territories of the country concerned or by the United States Government for diplomatic expenditure such as the purchase of buildings for Embassies and Consulates. The balance of 95 per cent. was originally intended to be used only for the reduction of the internal debt of the country concerned so as to produce a genuine counter-inflationary effect, but subsequent developments in the way of inter-European mutual financial assistance led to a modification of this original intention, and funds standing on Special Accounts were allowed to be used for the purpose of establishing credits in favour of other participants. This point is dealt with in greater detail in the latter part of this chapter.

In order to comply with the legal requirements imposed upon the use of E.C.A. funds, some rather complicated accounting arrangements had to be adopted by this country in order to preserve the identity of funds due to be held on Special Account. In theory, E.C.A. dollars would be provided for the purchase of goods which would only be handed over to the recipient country on their arrival, and would immediately be sold for local currency which would be placed straight away to the credit of the Special Account on which it would remain until used for the redemption of internal debt or some other approved purpose. In practice, however, the system of allocations, authorizations and the subsequent issue of Letters of Commitment, or cash reimbursements which had to be evolved necessarily obscured the relationship between E.C.A. dollars and the relative goods. In the case of this country, authorized purchases were invariably made out of our own reserves of gold and dollars, and reimbursement claimed subsequently from E.C.A., and in order clearly to show the sterling equivalent of all E.C.A. dollars received the following process was adopted :

(1) The Exchange Equalization Account would be holding gold and exchange which it had purchased for sterling raised by means of discounting with the Bank of England or the Money Market, the necessary amount from its authorized reserve of Treasury bills. This operation was in fact a new creation of public debt against the security of gold or exchange.

(2) When gold or exchange was needed to make payment for authorized E.C.A. purchases the Exchange Equalization Account supplied it against payment of the equivalent in sterling either by a Government Department making a bulk purchase or by an authorized importer. This sterling was at once used to redeem an equivalent amount of Treasury bills so that the public debt was decreased to the same extent as the assets of the Account were reduced.

(3) In due course E.C.A. dollars were placed at the disposal of the British Treasury and were at once handed over to the Exchange Equalization Account, which paid for them by transferring to the Treasury the necessary sterling equivalent out of its reserve of Treasury bills. At this stage, therefore, the public debt had been increased by the Account against a corresponding increase in its assets, but the increase in the public debt was an internal operation as no sale of Treasury bills had actually taken place.

(4) As a counter-entry to the newly-acquired asset and to maintain the identity of the sterling equivalent of the E.C.A. dollars, the Treasury required the Paymaster-General to open a Suspense Account to receive the counter-value of the Treasury bills handed over to it by the Account. This again was an internal operation.

(5) At the same time and in order to meet the legal requirements of the E.C.A. the Treasury opened a Special Account with the Bank of England which was credited with the exact sterling equivalent of the E.C.A. dollars received, and it was covered by the issue by the Treasury to the Bank of non-interest-bearing notes. This involved the nominal creation of a further amount of public debt.

(6) The final operation took place when the E.C.A. agreed

to the release of a stated sum from the Special Account for the redemption of public debt. The Special Account at the Bank of England was thereupon debited with the authorized sum against the retirement of the equivalent in the non-interest-bearing notes, thus cancelling that amount of newly-created public debt. At the same time, the Suspense Account held by the Paymaster-General was debited with the same amount against the cancellation of the equivalent in Treasury bills out of the holding of such bills by the Treasury against which the Suspense Account had been created. It was at this stage that the effective cancellation of public debt took place. The Treasury in the first instance was responsible for the issue to the Exchange Equalization Account of the Treasury bills which formed its capital. The Account had used some of these bills to acquire assets in the shape of E.C.A. dollars, and those bills had passed back to the Treasury. When the Treasury were placed in the position of being able to cancel those bills, the total public debt was reduced by that sum, while the national holding of gold and exchange had undergone no change (ignoring other intervening operations by the Account) because the Account had first supplied gold or exchange and used the sterling proceeds to withdraw Treasury bills, while in the second place it had received back gold or exchange to the extent of its original sales which it paid for by the re-issue of Treasury bills.

This complicated system of accountancy may seem cumbersome, but has actually worked quite smoothly in practice. The Special Account first appeared in the Bank of England weekly statement dated 4th August, 1948, when a sum of nearly £33½ millions was shown as standing to the credit of "H.M. Treasury Special Account," and by the end of September, 1948, the Account was shown to be in credit to the extent of over £53½ millions. On 6th October, 1948, the first authorization was given by the E.C.A. for the use of funds from this Special Account for the redemption of short-term debt, and an amount of £50,100,000 was withdrawn from the Account for this purpose. Subsequently similar with-

drawals of sums as small as £1½ millions were authorized within a few weeks, and it seems that the Special Account is not intended to hold balances of any size, and each credit is shortly followed by a debit of almost the same amount.

The allocations of E.R.P. Aid proposed by the O.E.E.C. and subsequently approved by the E.C.A. for the year ending 30th June, 1949, were as follows :—

	$
Austria	217 millions
Belgium-Luxemburg	250 ,,
Denmark	110 ,,
France	989 ,,
Greece	146 ,,
Ireland	79 ,,
Iceland	11 ,,
Italy	601 ,,
Netherlands	496 ,,
Norway	84 ,,
U.K.	1,263 ,,
Sweden	47 ,,
Trieste	18 ,,
Turkey	50 ,,
Bizone	414 ,,
French Zone	100 ,,

These figures represent the minimum requirements of the participant countries for the period in question and show the dire need of Europe for outside assistance. It must be remembered that several thousand million dollars had been poured into Europe between 1944 and 1947 by the United States *and this country* through U.N.R.R.A. operations and in other forms of free grants, while this country had spent nearly $4,000 millions between 15th July, 1946, and 21st August, 1947. The cost to this country of aid given to the British Zone of Occupied Germany alone had been running at the rate of over $320 millions per annum. When all these figures are added together some idea of the ravaged state of Europe can be

obtained and the problem clearly divided itself into two parts, namely, funds required for capital reconstruction, such as rail-, road- and bridge-building, rehousing, and rebuilding of factories, renewal or replacement of factory and mining equipment, etc., while at the same time the cost of feeding, clothing and housing the labour force engaged on these capital works was also capital expenditure; and, secondly, the outlay on current production which would have been covered within a little by current receipts from the sale of such production at home and abroad.

Had these problems been recognized, and had the principle of joint responsibility for the monetary costs of war been applied, a very different picture would have been presented. In June, 1942, President Roosevelt enunciated the principle that if each of the United Nations devoted roughly the same fraction of its national production to war, then the financial burden of war would be distributed equally amongst them in proportion to their ability to pay, and the money cost of the war would then be met in accordance with the rule of equality of sacrifice. This principle was supported in detail by President Truman in August, 1945, but for some obscure reason, it does not appear to have been pursued, either by the American authorities or by any of the British Financial Missions to the United States. The application of this principle would have shown amazing results and would have provided the most simple and direct solution of the problems of Europe. Official American calculations ascertained the actual percentage of national income which each member of the United Nations was devoting to war expenditure, and from this a common denominator was worked out to show the percentage which each member should have been called upon to devote to the common cause to ensure equality of monetary sacrifice. This fraction was actually 35.9 per cent., and on the assumption that each member nation contributed this percentage of its national income to a common pool out of which each of them would draw their actual war expenditure, the following striking result is shown. The table is constructed on the

assumption that each member nation had paid into the pool the agreed percentage of its national income, and then shows the differences receivable and payable by the principal members between such payments into the pool and their actual war expenditure:—

	Pool Creditors *£ million*		*Pool Debtors* *£ million*
U.K.	5,801	U.S.A.	7,577
Russia	1,992	Australia ..	394
Canada	182	New Zealand ..	4
	7,975		7,975

If, therefore, this eminently wise and fair principle had been adopted, this country would have been entitled to draw either during the war or at the conclusion of hostilities a sum of £5,801 millions, or over $23 billions, out of the pool into which the U.S.A. would have been due to pay over $30 billions. With such a sum at our disposal, there would have been no need for the American Loan or for any participation in Marshall Aid, and we could have made sterling internationally convertible within a very short time, to the great betterment of international trading operations, and also we undoubtedly would have given immediate and substantial aid to our Continental allies.

It may also be mentioned that in addition to the extreme sacrifices made by this country in the prosecution of the war, we have given since the conclusion of hostilities, a greater volume of aid, in proportion to our national income, to other war-ravaged countries than has the U.S.A. herself. During the war we made various loans to other European countries of which nearly £300 millions was still outstanding in November, 1948, and on which we have received only just over £12 millions by way of interest. In addition, we have made an interest-free loan of £10 millions to Greece. Beyond this, however, we had made outright gifts to international organizations and to certain liberated countries to a total of nearly

£401½ millions, or over $1,600 millions. The principal items in this total were as follows:—

		£ millions
Contributions to U.N.R.R.A.		155
Contributions to I.R.O.		11.2
Gifts of surplus equipment—	Italy	55
	Holland	16
	Burma	15
	Italian Colonies ..	11.8
	Austria	10
Assistance to Greece		29
Other liberation assistance		49

Nothing will be recovered in respect of these items, and they therefore represent a free gift out of our sadly depleted resources.

One of the most interesting results of the war has been the development of an ideal for a Union of Western Europe, but the best methods by which this may be accomplished are still under discussion at the time of writing. It is evident that it will be very necessary to " make haste slowly " in order that national pride may not be hurt by being required to surrender too quickly part of the complete sovereign rights which the respective nations have hitherto exercised within their own borders. The first step towards this ideal was taken as long ago as September, 1944, when the Governments of Belgium, Holland and Luxemburg which were still in exile, signed an agreement in London for an eventual Customs Union. This meant that ultimately the three countries would have a common level of tariffs as regards the rest of the world, but that existing tariff barriers between the three of them would gradually be removed entirely. It was agreed that these measures should be put completely into force by January, 1950, and on 1st January, 1948, the Customs frontier between Holland and the Belgo-Luxemburg Economic Union was abolished and a wide degree of common import duties against the rest of the world was introduced. This represented a

considerable advance towards the integration of the three countries into a single economic unit. The group has since become known as the "Benelux" countries. This was followed in March, 1948, by the signature in Brussels of a fifty-year treaty between Great Britain, France, Belgium, Luxemburg and Holland. The signatories to the Brussels Treaty bound themselves to "organize and co-ordinate their economic activities as to produce the best possible results by the elimination of conflict in their economic policies, the co-ordination of production, and the development of commercial exchanges." Up to the time of writing these objectives are still the subject of discussion, and no definite steps have been taken to secure their implementation. As a result of the obligations undertaken by the nations receiving E.R.P. Aid under their bilateral agreements with the United States, plans for a much wider European Union are under consideration, and it would give mutual co-operation not only in regard to economic and commercial affairs, but also for mutual defence against aggression, with the ultimate aim of setting up a Western Union Assembly to act as a kind of advisory Parliament to secure universal adoption within the Union of recommended measures. America, of course, would like to see a kind of United States of Europe, but such an ideal still lies in the womb of time and must be dependent upon a number of at present imponderable factors. The effects of any Western European economic co-operation such as is envisaged by the Brussels Treaty must depend upon the extent to which the Government of each of the member countries will find it necessary to control trade and industry within its own borders in order to assist to the greatest possible extent in the economic development of the Union as a whole. Logically, each member country should concentrate on the production of those natural products, raw and semi-processed materials and manufactured articles which its natural resources, industrial set-up and talents of its people render most economic. This, however, may well result in temporary hardship to certain existing classes of industry. It might be necessary, for

example, for the British Government to refuse allocations of raw material and labour to a certain branch of manufacture in this country which was competing with a similar product traditionally and economically produced in another member country. In theory, of course, this would lead to the most economical and even distribution of supplies of raw material and labour for the production within the Union of its general needs, but the field for argument opened up by such proposals is immense.

The bilateral agreement entered into with the United States by the nations participating in the E.R.P. also required them to take the earliest possible steps towards mutual co-operation both economically and financially and for the maximum development of trade between themselves. A serious unbalance of trade between the Western European countries had manifested itself during 1947 owing to the more serious devastation and slow speed of recovery in some countries than in others. Belgium, for instance, was at war for only a little over six months and then had over five years of German occupation, but during that time her industries were kept in full production, her industrial equipment was reasonably well maintained, and her agricultural industry increased. The end of the war, therefore, found her economy more or less intact, while she had built up substantial dollar resources out of the proceeds of exports from her colonies, such as rubber and diamonds. Consequently she felt capable of removing at a very early stage most of the controls on consumer goods and prices, with the result that the post-war life of her citizens returned practically to the pre-war normal. Her productive capacity left her with a handsome export surplus of goods and basic materials, which were urgently required by her neighbours, even including this country, and she quickly became a heavy creditor of almost every country in Europe. This position, however, could not continue, as a point was reached at which further extensions of credit to foreign buyers would have created a dangerous volume of internal inflation, while the foreign buyers could not sell to Belgium anything like enough

of their own products to produce the requisite amount of purchasing power in Belgium to buy Belgian goods. Belgian export trade consequently tended to fall, and the general shortage of Belgian francs extended even to the countries of South America, so that this currency became almost as "hard" as the U.S. dollar. As regards this country, our magnificent effort in the change-over from wartime to peacetime production and our willingness to assist in the recovery of our neighbours in every way possible to us, also resulted in our becoming heavy creditors of certain European countries, particularly France, and here again a point was reached at which France, through complete lack of sterling purchasing power, had to curtail her imports from this country and from the other countries of the Sterling Area, while our own state of inflation prevented the extension of further credits to France.

The correction of this serious situation of unbalance was one of the vital points in the plans for European revival considered by the O.E.E.C., but the creditor countries proved conclusively that they could not continue further the granting of unrequited credits to their neighbours on account of the grave effects of their own economies which the resulting inflation of the volume of internal credit would produce. After much discussion, the American E.C.A. Authorities agreed to the allocation of additional dollar aid to certain countries equivalent to the aid which they in turn were prepared to give to their neighbours. In both cases the assistance was to be by way of a free grant in the currency of the donating country, and the gifts between participating countries were allowed to be made out of the Special Account in its own currency put up against the receipt of the E.R.P. dollars by the donating country. The American authorities at first insisted that the Inter-European free grants should be transferable between any of the participants, *e.g.*, if this country made a sterling grant to France which France did not wish to use entirely within the Sterling Area, she would be free to transfer such unwanted portion of the grant to some other participating country which was prepared to use the

sterling within the Sterling Area and from which France could obtain an equivalent in essential goods. This country, however, had to refuse such a degree of inter-transferability of credits. We had entered into an Agreement with certain other participating countries before the commencement of the flow of E.R.P. Aid under which it was agreed that the other party to each such agreement should not be required to hold sterling balances in excess of a stated figure, and that if, in fact, the sterling balances of the other country exceeded that figure at any time, this country would purchase the excess amount in exchange for gold or U.S. dollars. In particular, we had entered into such an agreement with Belgium, and as the balance of trade between the Belgian Monetary Area and the Sterling Area had been consistently favourable to the former so that the agreed maximum holding of sterling by Belgium had already been reached, we had been compelled to part with a certain amount of our reserves of gold and dollars to redeem Belgian excess sterling balances, and the Sterling Area as a whole had also been compelled to restrict its imports from the Belgian Monetary Area. This country, therefore, could not contemplate further transfers of sterling to Belgium by other countries to which we had made sterling grants, as either we should have had to repurchase such sterling for gold or dollars, or imports from the Belgian Monetary Area into the Sterling Area would have had to be still further curtailed.

Eventually a limited transferability of inter-European grants was agreed upon and formed the subject of an Agreement between the sixteen participating nations signed in Paris on the 16th October, 1948. This Agreement provided for what were called First and Second Category Compensations. A First Category Compensation applied to an operation which produced for any Contracting Party either a decrease in one or more debit balances against an equivalent decrease in one of more credit balances, or the use by a debtor of part of a free grant established by the relative creditor in its favour for the purpose of offsetting a current deficit, or the balance of deficits

previously incurred with that creditor. These First Category Compensations can be effected without any further consent of the creditor or grantor being required. Amounts were to be determined monthly, and the agent for effecting compensations or offsets was the Bank for International Settlements in Switzerland. Second Category Compensations were defined as being any operation other than a First Category Compensation which resulted in the increase of any balance or the formation of a new balance in favour of a Contracting Party as compared with the position before the operation. These Second Category Compensations required the previous consent of each of the Contracting Parties directly concerned with the operation, but it was agreed that any reasonable proposition put forward should be facilitated by all parties to the fullest possible extent.

As will be seen from the table given below, this country made by far the biggest contribution by agreeing to provide grants in sterling equivalent to a total of U.S. \$312 millions, and against this she only received a grant from Belgium of the Belgian franc equivalent of U.S. \$30 millions. Belgium was the next largest contributor, and granted the Belgian franc equivalent of U.S. \$218½ millions, against which she received from Italy a grant in Italian lire of the equivalent of U.S. \$11 millions. Transferability of any of these grants is ordinarily limited to operations which fall under the heading of First Category Compensations. Thus if France wished to buy timber from Norway and Norway wished to buy tinplate from this country, but had exhausted her sterling balances (she was not allotted any sterling grant by this country), France could request the Bank for International Settlements to transfer from the sterling standing to her credit under our grant to her a sum sufficient to meet the sterling required by Norway for the purchase of tinplate from us (or for the purchase of wool in Australia, rubber in Malaya, etc.). On the other hand, if Turkey wished to buy galvanized sheets from Belgium but had no credit facilities or Belgian franc balances remaining available, she could not offer to pay Belgium in sterling as long

as Belgium held sterling credit balances; only if sterling deficits on the part of Belgium were apparent would such a transfer be permissible, as otherwise it would fall under the heading of Second Category Compensation, and would require the agreement of all parties concerned. The table now given shows the credit rights which it was agreed should be established between the various parties, the plus sign against each country in the extreme left-hand column signifying the amount granted by it in credits to other countries, while the minus sign shows the amount of credits which it receives from other countries. Although the table is expressed in terms of U.S. dollars, it must be borne in mind that all grants are made in terms of the currency of the grantor country, *e.g.*, Belgium in Belgian francs, Holland in guilders, Bizonia in deutschemarks, etc.

In addition to the free grants of sterling made by this country, as shown in the table, we also agreed to the use by Italy of just over £11 millions and by Greece of about £3½ millions out of their existing sterling balances, for the making of purchases within the Sterling Area. The total of sterling made available to other participating countries for the first period of E.R.P. ending 30th June, 1949, was thus about £85 millions over and above whatever favourable balance of sterling payments might accrue to any participant during the period as a result of current trading and financial transactions. This, of course, represented unrequited exports and a definite inflationary potential. As a counter to these dangers it was agreed that no participant should make available any part of a proposed grant in its own currency to another participant until it had actually received an equivalent in E.C.A. dollars, and which the E.C.A. agreed were part of the "additional aid" included in the global allocation to the participant concerned in consideration of the grant in question. It was also agreed, in November, 1948, that Inter-European Aid should be made retrospective to 1st October, 1948, and that accounts should be balanced at monthly intervals. Any deficit between a grantee and a grantor country for any given month was then

INTER-EUROPEAN CREDITS AND CLEARING SCHEME

MILLIONS $

Column No.		Austria 1	Belgium 2	Denmark 3	France 4	Greece 5	Italy 6	Holland 7	Norway 8	Sweden 9	Turkey 10	U.K. 11	Bizonia 12	French Zone 13	Gross Contributions 14	Gross Drawing rights 15	Nett contributions or Drawing Rights 16
Austria ...	+					0·4	2			0·7					3·1		
	−		4·5	0·1	2			1	1·5			25	32	0·5		66·6	63·5
Belgium ...	+	4·5		6·5	40	13		72·5	23	6	2	30	17	4	218·5		207·5
	−						11									11	
Denmark ...	+	0·1				2				3					5·1		
	−		6·5		2·7						1·5		1	0·2		11·9	6·8
France ...	+	2		2·7		5									9·7		
	−		40				11		5			200	63	14		333	323·3
Greece ...	+																
	−	0·4	13	2	5		7	5	2	5	13	10	4·3	0·1		66·8	66·8
Italy ...	+		11		11	7			0·5	0·1	5		10·1	2·6	47·3		20·3
	−	2										25				27	
Holland ...	+	1				5			2·5		0·8			2	11·3		
	−		72·5							2			8·5			83	71·7
Norway ...	+	1·5			5	2							8		16·5		
	−		23				0·5	2·5		21·8	0·5					48·3	31·8
Sweden ...	+					5		2	21·8		1		5		34·8		25
	−	0·7	6	3			0·1									9·8	
Turkey ...	+			1·5		13			0·5				12	1·5	28·5		19·7
	−		2				5	0·8		1						8·8	
U.K. ...	+	25			200	10	25						46·5	5·5	312		282
	−		30													30	
Bizonia ...	+	32		1	63	4·3		8·5							108·8		10·2
	−		17				10·1		8	5	12	46·5				98·6	
French Zone	+	0·5		0·2	14	0·1									14·8		
	−		4				2·6	2			1·5	5·5				15·6	0·8
TOTAL ...																	

+ Means granted by country to country named in numbered column.

— Means granted to country by country named in numbered column.

covered by the creditor placing at the disposal of the debtor a sum in its own currency sufficient to cover the deficit, provided that sufficient of the agreed total grant remained available and that the grantor had already received the equivalent in E.C.A. dollars. The first accounting period was, of course, for the month of October, 1948, and in respect of that month this country placed at the disposal of France, early in November, 1948, a sum of £7 millions out of the total agreed grant of £50 millions to cover the period to 30th June, 1949. At the same time, Belgium placed at the disposal of this country the Belgian franc equivalent to U.S. $13 millions out of her total agreed grant of the equivalent of U.S. $30 millions over the same period. For the month of November, 1948, we paid over to France a further £5 millions and received from Belgium the equivalent of another U.S. $13 millions, so that we were drawing on our Belgian franc grant much faster than France was drawing on her sterling grant.

The process of transfer and book-keeping entries were on the following lines:—

(1) As soon as a certain sum in E.C.A. dollars was agreed as being part of the " additional aid " given against grants, the process described earlier in this chapter would be followed exactly except that the eventual sterling created by the advance from the Bank of England against non-interest-bearing Notes would be credited, not to the usual " Special Account," but to another special account entitled " Intra-European Account." All subsequent payments by way of grants to other participating countries would be drawn from this account.

(2) If, for example, we were due to pay over £7 millions to France in respect of her deficit with the Sterling Area for the preceding month, the " Intra-European Account " would be debited and the account of the Bank of France with the Bank of England credited.

(3) Simultaneously, the equivalent in non-interest-bearing Notes would be handed back to the Treasury by the Bank of England, the Suspense Account kept by the Paymaster-General

would be debited with £7 millions, and Treasury bills to an equivalent amount handed back to the Treasury, and these bills would be discounted to provide the sterling credited to the account of the Bank of France so that the £7 millions would eventually come from the Money Market together with a small difference from Treasury funds.

(4) This last stage resulted in the creation of new sterling which would have been inflationary in effect, but this was countered by the withdrawal of cash from the credit system through the discounting of the Treasury bills. Consequently, when the Bank of France drew on these new funds so that they passed into the hands of the commercial bank system and so increased bank deposits, the system had already taken up practically the equivalent in Treasury bills, so that the increase in deposits was offset mainly by the increase in Treasury bill holdings, and only to a small extent by an increase in cash. The tendency, however, was to create a temporary shortage of Money Market funds during the short interval between the discounting of Treasury bills to provide funds for a grantee and the return of those funds into the credit system, as a result of payments made by the grantee.

In the case of the grants of Belgian francs made to this country by Belgium, they were treated in the same way as grants of E.C.A. dollars, namely, that the Belgian francs were handed over to the Exchange Equalization Account against the issue by the Account to the Treasury of the sterling equivalent in Treasury bills from its reserve, which enabled the Paymaster-General to credit the Suspense Account with the sterling equivalent against the cover provided by the Treasury bills, while the Special Account at the Bank of England was credited with the same sum against the issue by the Treasury to the Bank of non-interest-bearing Notes as cover. The inflationary potential, which would otherwise have resulted from the receipt of goods purchased with foreign currency for which we did not have to pay, was thus neutralized by the sterling equivalent being withdrawn from the credit system and becoming merged with other similar transfers to the

Special Account. While, however, the use of funds from the Special Account for the retirement of Treasury bills from time to time obviated the need for the Exchange Equalization Account to finance its purchases of foreign currency in the shape of E.R.P. dollars and Belgian donated francs by the issue of Treasury bills to the Market, it did not, in fact, constitute an absolute reduction of the outstanding total of public debt because, in its own books, the Exchange Equilization Account showed Treasury bills issued against foreign exchange acquired. The fact that these bills did not actually find their way on to the Market but were held by the Treasury and eventually cancelled, did not alter the volume of publicly issued debt. It would only be if the Exchange Equalization Account were wound up completely and its entire holdings of gold and foreign exchange were to be sold that it would find itself in possession of liquid sterling funds greatly in excess of the amount of Treasury bills which it had discounted in the Market to provide funds for its other purchases from time to time. This excess would then be immediately available for the purchase by the Treasury from the Money Market and general public of short- and long-term debt which could then be finally withdrawn and cancelled. The necessary legal authority for all these processes and book-keeping entries was conveyed by the "American Aid and European Payments (Financial Provisions) Bill, 1949."

The original Marshall Aid programme was designed to cover the four years from 1948 to 1952, and, as stated previously, each participating country had to submit its own four-year plan providing for a complete restoration of its economy and balance of payments by the end of that period, and these plans were then co-ordinated by the O.E.E.C. into a European Four-year Master Plan. The initial plans proved to be far too individualistic and optimistic, in that most of them assumed too great a volume of exports to some countries and of imports from others. When the plans came to be co-ordinated it was quickly apparent that the total estimated volume of exports to "hard" currency countries was much

in excess of the capacity of those countries to absorb, while the proposed imports from many " soft " currency countries were greatly in excess of their capacity to supply. At the time of writing, plans are being carried out on a temporary basis, and the longer term planning is more in the nature of fixing targets for both the volume and direction of trade which it is hoped to reach. There is no doubt, however, that many of the traditional directions of trade will have to undergo radical alteration. The steady growth of industrialization by most of the countries of the world has greatly reduced the absorbing capacity of many markets for foreign manufactured consumer goods. It is only in the production of capital goods that the old manufacturing countries still reign supreme. Also certain traditional products, such as Yorkshire cloth, Lancashire cottons, Staffordshire pottery, etc., seem likely to preserve their world-wide reputation and popularity for a long time to come, provided that not only are our prices kept competitive, but the total volume and value of world trade is kept at such a level as to place the necessary purchasing power in the hands of willing buyers.

One further piece of co-operative planning for the betterment of world conditions must be mentioned. In conjunction with the Bretton Woods Conference in 1945, the British and American Governments submitted proposals on international trade and employment for consideration by another International Conference. It must be said frankly that these proposals were a counsel of perfection and assumed conditions of universal peace on earth and goodwill towards all men, which unfortunately have not so far been realized. Also, the proposals contained a distinct American bias, as will be seen from the comments which follow. After a good deal of preparatory work a Conference of twenty-three nations assembled at Geneva in April, 1947, and what was designated as " the Charter of the International Trade Organization " was signed on 30th October, 1947. The Charter aimed at raising standards of living, ensuring full employment, and developing the full use of the resources of the world by " reciprocal and

mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and the elimination of discriminatory treatment in international commerce." The signatory nations agreed that the Charter should not enter into force definitely until it had been accepted by signatories accounting for at least 85 per cent. of the total external trade, and such acceptance would necessarily have to be by the passage of a law through each of the legislatures concerned, but, once the necessary majority of signatories had given such legal acceptance to the Charter, this was to become binding on the contracting parties until at least 1st January, 1951, after which date any contracting party was to be at liberty to withdraw separately from the Charter. Certain of the countries concerned, including Great Britain, Australia, the Benelux countries, Canada, France and the U.S.A., further agreed to apply the Charter provisionally as from 1st January, 1948, to the fullest extent possible under existing legislation in each of the countries concerned, and pending the full and formal ratification of the whole Charter. Much has in fact been done under this provisional arrangement, even though at the time of writing the Charter has not been formally ratified by any of the countries which have operated under these provisional arrangements. The assembly which adopted these arrangements was described as the Preparatory Committee of the United Nations Conference on Trade and Employment, and the result of their labours was presented to a full Conference of United Nations delegations held at Havana in March, 1948. After much argument and considerable pressure by the United States and countries within her sphere of influence, the Geneva proposals were adopted in the main, but with certain amendments designed to tighten up the obligations imposed on the signatory Governments. The eventual revised draft was generally accepted as the basis for the preparation of a final draft by the committees and sub-committees of the Conference, but five nations, including this country, made their acceptance subject to certain reservations. The British spokesman stated that his

Government regarded as definitely unsatisfactory the proposals in regard to preferential tariff systems, particularly in connection with development or reconstruction, and it also objected to the limitations imposed by the new text of the Charter on her freedom to discriminate in the use of quantitative restrictions when these were said to be permissible for countries in difficulties with their balance of payments. In spite of these objections, however, this country has entered into a variety of agreements for the reduction or stabilization of existing tariffs and preferences, but as the final form of the full Charter has not yet been drawn up at the time of writing, it has not been submitted to Parliament for ratification, and all the arrangements so far made have been carried through by Order in Council under existing legislation.

The main features of the proposed Charter are as follows :—

(1) The signatories undertake to enter into a series of bilateral agreements aimed at the mutual reduction of tariff barriers and preferences and at the greatest possible development of mutual trade. Theoretically this is a highly desirable objective, but it leaves out of account the post-war position of many important neutral countries who found themselves deprived by the war of supplies of all kinds of manufactured goods which they had previously obtained from the warring countries, and in consequence set to work to develop their own manufacturing industries in order to avoid a similar position arising in the future. Such countries will undoubtedly feel it essential to protect these newly-developed industries from outside competition, such as mass-produced American goods, whereas America with her intense desire to keep her highly-geared productive capacity going at full speed and never again to see a " bread-line " of twenty million unemployed, is most anxious to open up all possible world markets for the disposal of her exportable surplus.

(2) The signatories accept the principle of " general most-favoured-nation treatment," and undertake that any concessions granted to any one country shall immediately and unconditionally be granted to any other signatory country

which could supply a similar product. This again is excellent in theory, but in the present state of the world and of this country in particular, it carries the principle of non-discrimination too far. It means, for instance, that if we grant concessions in the shape of reduced tariffs to any of the Dominions in order to strengthen the bonds of the Commonwealth, we must simultaneously grant the same reduced tariffs to any other signatory country capable of supplying similar products to those to which the reduced tariffs would apply. It is, however, laid down in the Charter that these provisions shall not require the elimination of existing preferences between groups of signatories such as the British Commonwealth, but as will be seen later, the eventual elimination of preferences is definitely envisaged by the Charter.

(3) It is provided that any imported product shall be accorded treatment no less favourable than that accorded to like products of natural origin, which means chiefly that tariffs on imports must not be higher than internal excise duties on the same products. It also means that if " internal quantitative controls," *e.g.*, rationing, are in force, no regulations shall be made which would require that any specified amount or proportion of a particular product must be supplied from domestic sources, nor may restrictions be imposed on the use of a product which is either not made at home or made in smaller quantities, in order to protect the domestic production of a competitive product or substitute. Any such " internal quantitative controls " already in force may, however, be retained for the time being, but they may not be modified to the detriment of imports, and shall be subject to early negotiation for amendment and eventual elimination. Special reference is made to film quotas designed to ensure a minimum showing of home-produced films and such quotas may remain in force for the time being, but again shall be subject to early negotiation for reduction and ultimate elimination.

(4) Signatories may impose tariffs to prevent the dumping of goods by other countries, but only where it can be shown that such dumping causes material injury to the importing

country, particularly where the foreign exports are assisted by subsidies or bounties. The present system which is in use in this country and the United States amongst others, of guaranteeing minimum prices to home producers of primary products, and of paying subsidies to such products to the extent of any difference between guaranteed prices and the current market prices at home and abroad, is especially covered. Such practices are not to be regarded as resulting in material injury to any importing country as long as agreement to this effect between the contracting parties substantially interested can be reached. This, of course, will operate very favourably in regard to America, as she will be able to guarantee high prices to her home producers of primary products while still competing successfully in world markets.

(5) Quantitative restrictions on imports are to be eliminated whether made effective through quotas, import or export licences, or other measures. This is, of course, the application in full of the policy of non-discrimination. It means that if this country, through lack of dollar purchasing power, is unable or unwilling to buy grapefruit from Florida, she may not buy them from South Africa or Palestine or elsewhere. If we are forced to reduce our imports of American grapefruit to one-quarter of their normal volume, we must similarly reduce our imports of the same product from all other quarters, no matter what effect this may have on national diet. Once more American interest is very evident in this provision; she could not view with equanimity the diversion of purchases of her products to other countries capable of supplying similar products, as not only would this cause immediate danger to her export trade, but might even result in the complete loss of sections of that trade if new production, either of primary or manufactured products, were set up in some other country. In present circumstances, however, this provision is bound to bear hardly on certain countries, including this country, and although some small measure of relief is given in the shape of certain exceptions to this rule, it is not sufficient to enable this country, for instance, to cut its coat according to its cloth and make its

purchases from quarters in which it is best able to make them. The exceptions allow of export restrictions to prevent or relieve critical shortages of food or raw materials, and import restrictions may be imposed on any agricultural or fisheries product to allow the country concerned to remove a domestic surplus of a like domestic product. In other words, if Australia had a bumper wheat crop and world prices are lower than the level at which America wishes to maintain her internal prices, she can impose import duties on Australian wheat to prevent it from under-selling her own product in her own market. The serious effect of this clause, however, on the freedom of a country to shop to the best advantage, is one which will undoubtedly cause considerable debate when the final measure comes to be laid before Parliament, and was one to which the spokesman of the British delegation to the Havana Conference raised the strongest objection. Some further small protection is given later in the clause, in that a country may impose certain restrictions if these can be shown as essential to prevent a depletion of external reserves or to permit of a reasonable increase in such reserves if they had fallen to a very low level. No formula for the measurement of such a need is laid down, however, and no impartial body is designated to which cases could be submitted for a ruling. Whether this country, for instance, could justify the imposition of import restrictions in certain directions on the grounds of insufficient external reserves while those reserves are still in the neighbourhood of £500 millions is therefore an open question.

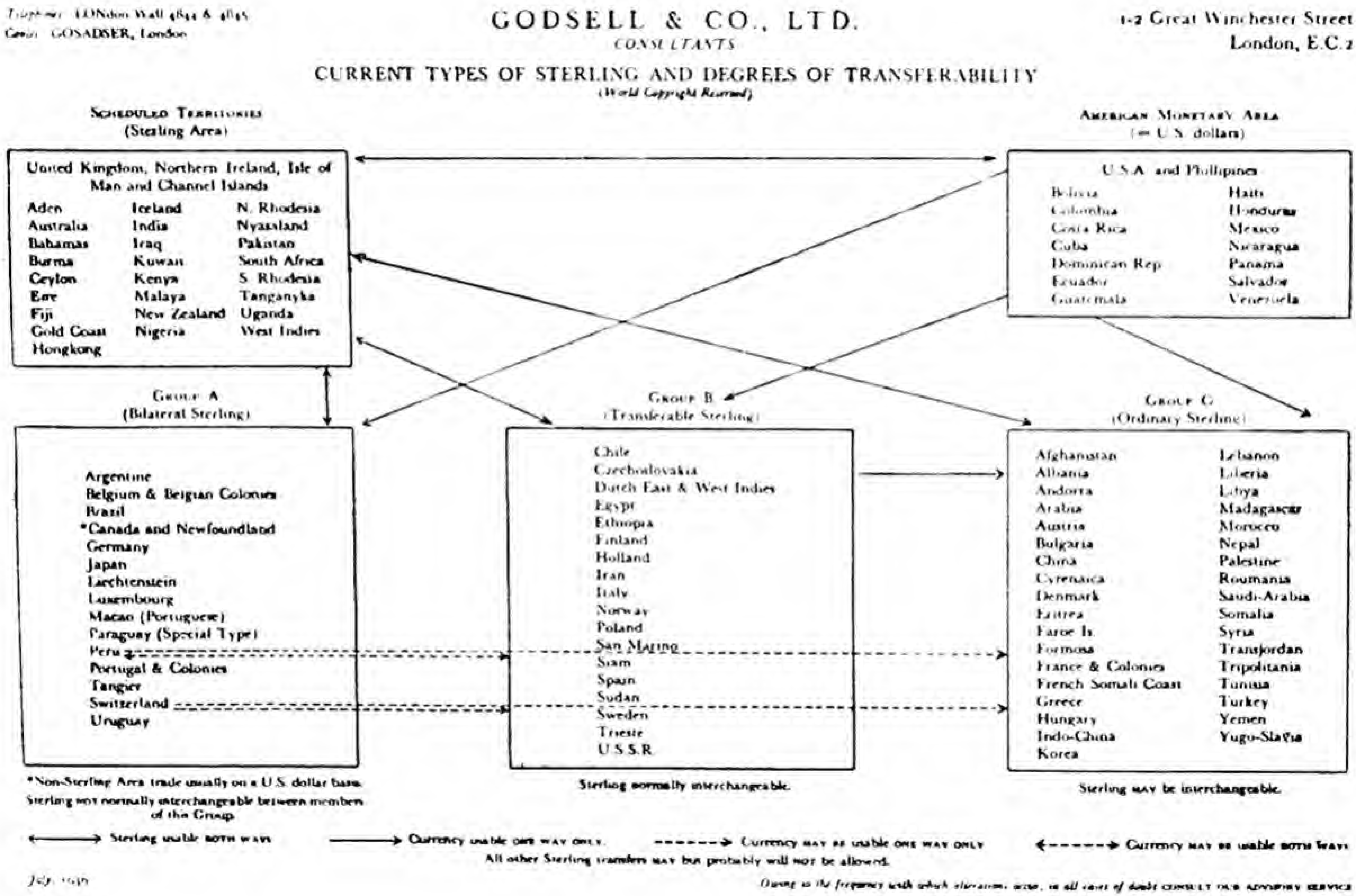
(6) There are a number of minor provisions which endeavour to cover special circumstances included in the agreement, and much emphasis is laid on the need for mutual discussion and agreement between signatories. The formation of Customs Unions is declared to be permissible, provided that no increase in the joint external tariffs is involved. As a constructive effort towards achieving eventually an optimum of world trade and employment, the Charter merits every consideration, but if it is forced upon the world in the present

state of general unbalance of trade and international payments, it can only result in an all-round contraction instead of the much-desired expansion.

As a result of the Geneva Agreement, a number of bilateral agreements for the mutual reduction or stabilization of tariffs and preferences were arranged. In the case of this country, twenty agreements were signed under which we undertook to reduce or stabilize existing duties on a wide range of goods of which our imports from all foreign countries concerned were valued in 1938 at just over £63 millions. Other Commonwealth countries entered into similar agreements covering imports to a 1938 value of £37 millions. In return for these concessions we received from the United States concessions which halved the duty on certain classes of goods of which our exports to the U.S.A. were valued in 1939 at £2½ millions, and which reduced by one-third or more duties on goods of which the 1939 import value was just over £10 millions, while on a further range of goods with a 1939 export value of £10 millions, we received either small reductions or the stabilization of existing duties. The greater part of these concessions, however, applied to goods which already enjoyed a ready market in America, such as woollen and worsted fabrics, linen piece goods and whisky, and the only concession which so far has shown any material benefit to this country is the reduction in the duty on toys. We also obtained concessions from France covering export trade with a 1938 value of about £7 millions, from Benelux in respect of 1938 export trade of about £14 millions, and much smaller concessions from Czechoslovakia, Norway, Brazil, Chile and the Lebanon-Syria Customs Unions. Most of these concessions on all sides were put into operation almost at once, but no startling results have yet been shown. While trade and employment are essential for the survival of the human race, they are not the only considerations in regard to that survival. Political unity and stability are at least as essential, and the British Commonwealth has for long set an example of these qualities to the rest of the world, and has provided the only solid foundation

for the continuance and development of international trade. It would be disastrous if this economic entity were to be in any way impaired by a too slavish adherence to economic dogma, and all our efforts should be devoted to cultivating and extending the peaceful oasis in an arid world which the British Empire and Commonwealth of Nations provides.

APPENDIX A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Luxembourg
Macao (Portuguese)
Paraguay (Special Type)
Peru
Portugal & Colonies
Tangier
Switzerland
Uruguay
GROUP B
(Transferable Sterling)
Chile
Czechoslovakia
Dutch East & West Indies
Egypt
Ethiopia
Finland
Holland
Iran
Italy
Norway
Poland
San Marino
Siam
Spain
Sudan
Sweden
Trieste
U.S.S.R.
GROUP C
(Ordinary Sterling)
Afghanistan
Albania
Andorra
Arabia
Austria
Bulgaria
China
Cyrenaica
Denmark
Eritrea
Faroe Is.
Formosa
France & Colonies
French Somali Coast
Greece
Hungary
Indo-China
Korea
Lebanon
Liberia
Libya
Madagascar
Morocco
Nepal
Palestine
Roumania
Saudi-Arabia
Somalia
Syria
Transjordan
Tripolitania
Tunisia
Turkey
Yemen
Yugo-Slavia
*Non-Sterling Area trade usually on a U.S. dollar basis.
Sterling not normally interchangeable between members of the Group.
Sterling normally interchangeable.
Sterling may be interchangeable.
Sterling usable both ways
Currency usable one way only.
Currency may be usable one way only
Currency may be usable both ways
All other Sterling transfers may but probably will not be allowed.
Owing to the frequency with which alterations arise, in all cases of doubt CONSULT OUR ADVISORY SERVICE

APPENDIX B

MEMORANDUM ON CURRENT TYPES OF STERLING AS USED ON CHART

Scheduled Territories (Sterling Area)

The countries in this Group concentrate all their exchange dealings in London, with the exception of India, Pakistan and South Africa, who are allowed to use their own exchange resources up to agreed levels. All the foreign exchange earnings of the Group are paid in to a central " Pool " in London, and allocations to each member country from this " Pool " are made at six-monthly intervals by agreement between the British Treasury and the other country concerned, after full consideration of the exchange requirements of the Group as a whole, and as compared with available and prospective resources. All exchange conversions are first conducted against sterling, and this sterling is then exchanged against the local currency, *e.g.*, Australian pounds, as and when desired. All the other types of sterling accounts are maintained only in London so that all transfers on behalf of Sterling Area member countries must be carried out in London.

American Monetary Area

The sterling accounts of countries in this Group are exchangeable into U.S. dollars on demand, and sterling can be created and credited to such accounts by sales of U.S. dollars to the British Control. Sterling on these accounts can be used for permitted transactions both ways between the Sterling Area and the American Area, and it can also be transferred without formality between any of the accounts in the American Area.

Bilateral Sterling

This term has been used to denote a type of sterling which by arrangement between this country and the other country

concerned is only eligible for use in permitted transactions between that country and the Sterling Area Group. In general the Agreements under which this type of sterling is created, provide that sterling shall *not* be used by the other country in any of its transactions with countries outside the Sterling Area, so that normally sterling cannot be transferred between the accounts of members of this Group. Owing to the constantly changing sterling position of these countries however, it is always possible that certain specific transfers may be authorized, and it is always worth while putting forward an actual inquiry in case the current position permits the British authorities to allow the transfer. The sterling accounts of members of this Group may *receive* transfers from any account in the American Monetary Area, but transfers from these accounts *to* the American Monetary Area are very seldom authorized. In most cases there is a good chance of transfers of sterling *from* the accounts of members of this Group to transferable sterling or ordinary sterling accounts being sanctioned, but an actual inquiry must be made in every case.

Transferable Sterling

This type of sterling was introduced early in 1947 as the first step towards making sterling internationally convertible. In all cases this is adopted under a special Agreement between this country and the other country concerned, and it is primarily used for permitted transactions between that country and the Sterling Area Group. In addition it can be transferred freely and without formality between any transferable account of members of the Group, and in most cases permission will be given for transfers of sterling *from* a transferable account to an ordinary sterling account, but very seldom for transfers in the reverse direction. Transfers from transferable accounts to bilateral sterling accounts are occasionally sanctioned, but very seldom are transfers to American accounts sanctioned. On the other hand, transfers *from* American accounts to transferable accounts can be made freely and without formality.

Ordinary Sterling

This term has been applied to sterling covered by a special Agreement between this country and the other country concerned, and also to the sterling accounts of countries with whom no formal Agreement has been made. This type of sterling is used by the country concerned for permitted transactions with the Sterling Area, and in most cases permission will be given for sterling transfers *between* members of this Group. Ordinary sterling accounts may receive transfers from American accounts and permission is usually given for transfers *from* bilateral and transferable sterling accounts, but it is very seldom that transfers *from* ordinary sterling accounts to American or bilateral sterling accounts are permitted, though sanction from transfers from ordinary sterling to transferable sterling accounts are more frequently allowed. Each proposed transaction of such a nature must, however, be the subject of a special inquiry to the Authorities.

APPENDIX C

LIST OF PRINCIPAL SCHEDULED TERRITORIES
(Sterling Area)

Aitutaki
Aden
Andaman Is.
Anguilla
Antigua
Ascension
Australia

Bahamas
Bahrein
Barbados
Barbuda
Basutoland
Bechuanaland
Bermuda
British East Africa
British Guiana
British Honduras
British New Guinea
British North Borneo
British Solomon Islands
British Somaliland
British South-West Africa
Burma

Caicos Islands
Cameroons
Cayman Islands
Ceylon
Cocos Islands
Cook Islands
Cyprus

Dominica

Eire

Falkland Islands
Fiji
Friendly Islands

Gambia
Gibraltar
Gilbert & Ellice Islands
Gold Coast
Grenada

Hongkong

Iceland
India
Iraq

Jamaica
Johore

Kedah
Kelantan
Kenya
Kermadec Is.
Kuwait

Labuan
Lagos
Leeward Islands

Malaya
Maldive Islands
Malta G.C.
Mauritius
Mesopotamia (Iraq)
Montserrat
Morocco Agencies
Muscat

Nauru
Negri Sembilan
Nevis
New Guinea
New Zealand
Nicobar Is.
Nigeria
Niue
Northern Rhodesia
Nyasaland

Pahang
Pakistan
Papua
Perak
Perim
Pitcairn Islands
Penrhyn Islands

Raratonga

St. Christopher
St. Helena
St. Kitts-Nevis
St. Lucia
St. Vincent
Samoa
Santa Cruz Is.
Sarawak
Selangor
Seychelles
Sierra Leone
Singapore
Sokotra
Solomon Islands

Southern Rhodesia
South-West Africa
Straits Settlements
Sungei Ujong
Swaziland

Tanganyika
Tasmania
Tobago
Togoland
Tonga Islands
Trinidad
Tristan da Cunha
Turks Islands

Trengganu

Uganda
Union Is.
Union of South Africa

Virgin Islands

Western Samoa
Windward Islands

Zanzibar

PERSIAN GULF SHEIKDOMS

These are administratively within the Scheduled Territories, and the responsibility for exchange control in the following Sheikdoms has been transferred to H.M. Government's Political Resident there :—

Bahrein
Kuwait
Dubai
Adu Dhabi

Shargah
Ajmen
Ras Al-Khaimah
Umm ul Quwain

Kalba
Qatar
Muscat
Oman (including Gwadur

October, 1948.

APPENDIX D

CURRENT UNITED KINGDOM RATING OF OTHER COUNTRIES ACCORDING TO CURRENT BALANCE OF PAYMENT

N.B.—" Hard " Currency means both that the U.K. is short of the currency of the country in question and that the other country holds more than sufficient sterling balances.

" Medium Hard " Currency means both that the U.K. has barely enough of the currency of the other country to meet current requirements and that the sterling balances of the other country are at least sufficient for its current needs.

" Soft " Currency means that the U.K. is not in need of or has more than adequate supplies of the currency of the other country, while that country is short of sterling, so that it is undesirable that it should become even shorter.

In general, the U.K. wishes to *receive* sterling particularly from " Hard " currency countries, and to a lesser degree from " Medium Hard " currency countries, but would prefer to *pay* sterling to " Soft " currency countries rather than to see further sterling debts incurred by such countries.

THE GROUPINGS GIVEN BELOW MUST NOT, HOWEVER, BE REGARDED AS IN ANY WAY PERMANENT; THE POSITION OF EACH RESPECTIVE BALANCE OF PAYMENTS IS CONSTANTLY CHANGING SO THAT THE GROUPING IS CONTINUOUSLY UNDER REVIEW. OUR ADVISORY SERVICE SHOULD BE CONSULTED FOR THE LATEST AVAILABLE INFORMATION.

"Hard" Currencies

ARGENTINE	ECUADOR	PANAMA
BELGIUM & COLONIES	GERMANY (Western)	PARAGUAY
BOLIVIA	GUATEMALA	PHILIPPINES
CANADA	HAITI	PORTUGAL & COLONIES
COLOMBIA	HONDURAS	SALVADOR
COSTA RICA	JAPAN	SWITZERLAND
CUBA	MEXICO	UNITED STATES
DOMINICAN REPUB.	NICARAGUA	VENEZUELA

"Medium Hard" Currencies

BRAZIL	FINLAND	SIAM
CHILE	HOLLAND	SPAIN
CZECHOSLOVAKIA	IRAN	SUDAN
DUTCH EAST & WEST INDIES	ITALY	SWEDEN
EGYPT	NORWAY	TANGIER
ETHIOPIA	PERU	URUGUAY
	POLAND	U.S.S.R.

"Soft" Currencies

AFGHANISTAN	FRANCE & COLONIES	PALESTINE
AUSTRIA	GREECE	ROUMANIA
BULGARIA	HUNGARY	SAUDI-ARABIA
CHINA	INDO-CHINA	SYRIA
CYRENAICA	LEBANON	TRANSJORDAN
DENMARK	LIBERIA	TRIPOLITANIA
ERITREA	MADAGASCAR	TUNISIA
FAROE IS.	MOROCCO	TURKEY
FORMOSA		YUGOSLAVIA

November, 1948.

APPENDIX E

PRESCRIBED METHODS OF PAYMENT FOR STERLING AREA EXPORTS

"Sterling T" means Sterling from *any* transferable sterling account.

"Sterling (followed by country)" means Sterling from the account of any resident of the named country.

"Sterling American" means Sterling from the account of any resident of the American Monetary Area.

1. ARGENTINE
   (*a*) Sterling Argentinian.

2. AUSTRIA
   (*a*) Sterling Austrian.

3. BELGIUM & HER COLONIES
   (*a*) Sterling Belgian. (*b*) Belgian, Luxemburg or Congolese francs.

4. BRAZIL
   (*a*) Sterling Brazilian.

5. BULGARIA
   (*a*) Sterling Bulgarian.

6. CANADA AND NEWFOUNDLAND
   (*a*) Sterling Canadian. (*b*) Canadian or Newfoundland dollars.

7. CHILE
   (*a*) Sterling T. (*b*) Sterling Chilian. (*c*) Sterling American.

8. CHINA & FORMOSA
   (*a*) Sterling Chinese or Formosan.

9. CZECHOSLOVAKIA.
   (*a*) Sterling T. (*b*) Sterling Czech. (*c*) Sterling American.

10. DENMARK, GREENLAND & FAROE ISLANDS
    (*a*) Sterling Danish, or Greenland or Faroese. (*b*) Danish or Faroese Kroner.

11. DUTCH MONETARY AREA

(*a*) Sterling T. (*b*) Sterling (from any account of a resident in the Dutch Monetary Area). (*c*) Sterling American. (*d*) Dutch or Dutch East or West Indies Guilders.

12. EGYPT

(*a*) Sterling T. (*b*) Sterling Egyptian. (*c*) Sterling American.

13. ETHIOPIA

(*a*) Sterling T. (*b*) Sterling Ethiopian. (*c*) Sterling American.

14. FINLAND

(*a*) Sterling T. (*b*) Sterling Finnish. (*c*) Sterling American.

15. FRENCH FRANC AREA

(*a*) Sterling from any French No. 1 account only. (*b*) French francs or the currency of any of the territories included in the French Franc Area.

15a. FRENCH SOMALI COAST

(*a*) Sterling French Somali. (*b*) Djibouti Francs.

16. GERMANY

(*a*) Sterling German.

17. GREECE.

(*a*) Sterling Greek.

18. HUNGARY

(*a*) Sterling Hungarian.

19. IRAN

(*a*) Sterling T. (*b*) Sterling Iranian. (*c*) Sterling American.

20. ITALY

(*a*) Sterling T. (*b*) Sterling Italian. (*c*) Sterling American.

21. JAPAN

(*a*) Sterling (official).

22. LEBANON

(*a*) Sterling Lebanese.

23. NORWAY

(*a*) Sterling T. (*b*) Sterling Norwegian. (*c*) Sterling American. (*d*) Norwegian Kroner.

24. PALESTINE

(*a*) Sterling from the account of any resident of Palestine other than a No. 2 account.

25. PARAGUAY

(*a*) Sterling from a Paraguayan special account.

26. PERU

(*a*) Sterling from a Peruvian account.

27. POLAND

(*a*) Sterling T. (*b*) Sterling Polish. (*c*) Sterling American.

28. PORTUGAL & HER COLONIES

(*a*) Sterling from the account of any resident in the Portuguese Monetary Area. (*b*) Portuguese Escudos.

(N.B.—Payment in Angolas needs special reference.)

29. ROUMANIA

(*a*) Sterling Roumanian.

30. SAN MARINO

(*a*) Sterling T. (*b*) Sterling San Marino. (*c*) Sterling American.

31. SIAM

(*a*) Sterling T. (*b*) Sterling Siamese. (*c*) Sterling American.

32. SPAIN & HER COLONIES

(*a*) Sterling T. (*b*) Sterling from the account of any resident in the Spanish Monetary Area. (*c*) Sterling American.

33. SUDAN

(*a*) Sterling T. (*b*) Sterling Sudanese. (*c*) Sterling American.

34. SWEDEN

(*a*) Sterling T. (*b*) Sterling Swedish. (*c*) Sterling American. (*d*) Swedish Kroner.

35. SWITZERLAND & LIECHTENSTEIN

(*a*) Sterling Swiss or Liechtenstein. (*b*) Swiss francs.

36. SYRIA

(*a*) Sterling Syrian.

37. TANGIER

(*a*) Sterling Tangier.

38. TRANSJORDAN

(*a*) Sterling Transjordan.

39. TRIESTE

(*a*) Sterling T. (*b*) Sterling Trieste. (*c*) Sterling American.

40. TURKEY

(*a*) Sterling only from a full Turkish account (*not* from a Turkish private account).

41. U.S.S.R.

(*a*) Sterling T. (*b*) Sterling U.S.S.R. (*c*) Sterling American.

42. URUGUAY

(*a*) Sterling Uruguayan.

43. U.S.A. & countries of the AMERICAN MONETARY AREA. (See Chart.)

(*a*) Sterling American. (*b*) U.S. dollars.

44. VATICAN CITY

(*a*) Sterling Vatican.

45. YUGOSLAVIA

(*a*) Sterling Yugoslav.

46. OTHER COUNTRIES. (See Information Sheet No. 28.)

(*a*) Sterling T. (*b*) Sterling from the account of a resident in any one of the countries in this Group. (*c*) Sterling American.

APPENDIX F

MARSHALL AID

A SPECIAL GLOSSARY

C.E.E.C.

The Committee of European Economic Co-operation, set up in Paris, 12th July, 1947, consisting of sixteen participating nations: Austria, Belgium, Denmark, Eire, Greece, Iceland, Italy, Luxemburg, the Netherlands, Norway, Portugal, Sweden, Switzerland, Turkey, the U.K. and France. President: Mr. Ernest Bevin (U.K.), with Sir Oliver Franks (U.K.) as his alternate.

FUNCTION.—To formulate a programme for European Economic Recovery which aimed at restoring European economy by 1951, and to determine the manner and extent to which the participating countries could by their individual and collective efforts bring about the achievement of that programme.

Committee on Payments Agreements

Created at the Paris Conference of the C.E.E.C. and consisting of five participant nations; Denmark, France, Italy, the Netherlands and the United Kingdom.

FUNCTION.—To seek a system whereby settlement of payments between themselves could be made, and to pursue the problem of currency transferability within Europe to the fullest possible extent in the absence of dollar assistance.

Council

The Council of the Organization for European Economic Co-operation, on which all participating nations are represented. President: M. Spaak (Belgium).

FUNCTIONS.—To act as the body making all the decisions concerning European Economic Recovery and Co-operation.

Customs Union (Study Group)

Created 12th September, 1947, by the C.E.E.C., and consisting of thirteen participant countries: Austria, Belgium, Denmark, Eire, France, Greece, Iceland, Italy, Luxemburg, the Netherlands, Portugal, Turkey and the U.K.

FUNCTION.—To examine the problems involved, and the steps to be taken, in the formation of a Customs Union between the various Governments invited to participate in the work of the Group, in order to assist in the reconstruction of European economic unity.

E.C.A. (Marshall) Aid

The Economic Co-operation Administration, set up under the Economic Assistance Act of the U.S., 1948. Administrator: Mr. Paul G. Hoffman. Assistant Administrator: Mr. Howard Bruce.

FUNCTIONS OF E.C.A.—To administer the dispensation of the sum authorized for foreign aid by the U.S. Foreign Assistance Act, 1948.

FUNCTIONS OF THE ADMINISTRATOR.—(1) To review the requirements of the participant countries for assistance. (2) To formulate programmes of U.S. assistance, including approval of specific projects submitted to him by the participant countries. (3) To provide for the efficient execution of such programmes. (4) To terminate provision of such assistance to any participating country in any case of default of agreement by that country.

Economic Co-operation Act, 1948

The United States Economic Co-operation Act, 1948, being otherwise known as TITLE ONE of the United States Foreign Assistance Act, 1948.

FUNCTIONS.—(1) To further the restoration, or maintain the soundness of European currencies, budgets and finances, especially by authorizing the allocation of $5,000 millions to the European Recovery Programme out of the sum authorized

for foreign aid under the U.S. Foreign Assistance Act, 1948. (2) To facilitate and stimulate the growth of international trade of the participant countries of the C.E.E.C.

Economic Co-operation Agreements

Otherwise known as "Bilateral Pacts," negotiated and signed individually between the U.S. and each country participating in the E.C.A.

FUNCTIONS.—These define the conditions under which assistance is granted. Countries are not eligible for assistance by the E.C.A. until these agreements have been signed. They embody also primarily the conditions of self-help and mutual co-operation judged by the Paris Conference of the C.E.E.C. as essential for permanent European Recovery.

The Executive

The Executive of the Organization for European Economic Co-operation, consisting of seven members elected annually by the Council. The present members are: France, Italy, Switzerland, the Netherlands, Sweden, Turkey and the U.K. President: Sir Edmund Hall Patch (U.K.).

FUNCTIONS.—To complete the necessary administration work of the Council of the Organization, and to govern the functions of the various technical committees.

E.R.P.

The European Recovery Programme, the four-year programme for their own economic recovery, formulated by the participating countries of the C.E.E.C. and Western Germany, from the programmes provided by the Working Committees set up by the C.E.E.C.

The programme determines: (1) A strong production effort by each country; (2) the creation and maintenance of internal financial stability in each of those countries; (3) the development of economic co-operation between each participating country; and (4) a solution of the problem of the participating

countries' deficit with the American continent, particularly by increasing their exports to that continent.

Foreign Assistance Act, 1948

The United States Foreign Assistance Act, 1948.

FUNCTION.—To authorize the expenditure of $6,500 millions on foreign aid, especially on the European Recovery Programme (see the Economic Co-operation Act).

The Joint Committee

The Joint Committee on Foreign Economic Co-operation, consisting of five U.S. Senators and five members of the House of Representatives.

FUNCTION.—To act as the " Congressional Watch-dog " on the E.C.A.

N.A.C.

The National Advisory Council on International Monetary and Financial Problems, originally created under the Bretton Woods Agreement and now amended to conform to the requirements of E.C.A.

FUNCTION.—To co-ordinate the policies and operations of all agencies of the U.S. Government which make or participate in making foreign loans, or which engage in foreign financial, exchange or monetary transactions.

O.E.E.C.

The Organization for European Economic Co-operation, created at the second Paris Conference of the C.E.E.C.

FUNCTIONS.—To act as a permanent organization to continue the work of the C.E.E.C., and to implement the offer of American aid by (1) Assembling information about the needs of participant countries; (2) answering questions by the Economic Administration in Washington; (3) allocating to participant countries the dollars and commodities set aside in Washington for that purpose; and (4) undertaking the general

task of integrating European economy by promoting intra-European trade.

The participating nations are: Austria, Belgium, Denmark, Eire, France, Greece, Iceland, Italy, Luxemburg, the Netherlands, Norway, Portugal, Sweden, Switzerland, Turkey, the U.K., Bizonia and the French zone.

Public Advisory Board

The Advisory Board to the Economic Co-operation Administration, consisting of twelve prominent U.S. citizens, with the Administrator as chairman.

FUNCTION—To advise the Administrator on all general or basic policy matters arising in his discharging of his duties.

The Secretariat

The Secretariat of the Council of the O.E.E.C. The members of the Secretariat are selected by the Secretary-General, who is in charge of the Secretariat and is in turn selected by the Council. Present Secretary-General: M. Marjolin (France).

FUNCTIONS.—To staff the Technical Committees of the Executive, and to administer the general work of the organization. There are six departments to the Secretariat: (1) Technical and Programmes (to deal with the programmes produced by the Working Committees and to weld them into one coherent programme for the whole group); (2) Trade and Payments (to deal with the problems of the intra-European credits of members of the organization, and clearing systems for those credits); (3) Administration (dealing with the budget and personnel problems of the Organization; (4) General Affairs (including liaison with outside international bodies); (5) Conferences (dealing with the agenda, etc.); and (6) Balance of payments.

Special Missions

Special units of the E.C.A., despatched to each of the participating countries, under the direction of a chief.

FUNCTION.—To be responsible for ensuring the correct and efficient performance in that country of operations conducted under the E.C.A. The Chiefs of the Special Missions: to the U.K., Mr. Thomas K. Finletter; to France, Mr. David K. Bruce; to Denmark, Mr. Charles A. Marshall; to Italy, Mr. James D. Zellerbach; to Sweden, Mr. John Haskell; and to Greece, Mr. John Nuveen, junior.

The Special Representative

The United States Special Representative in Europe (headquarters in Paris), known also as the Ambassador-at-Large for the E.C.A. Present Special Representative: Mr. Averell Harriman. Deputy Special Representative: Mr. William C. Foster.

FUNCTION—To act in Europe on behalf of the Administrator in all matters concerning the E.C.A., and to act as the U.S. representative on any organization that participating countries may set up to further a joint programme of European Recovery (for example, the O.E.E.C.).

Technical Committees

The Working Committees created at the Paris Conference of the C.E.E.C. and continued by the O.E.E.C.

FUNCTIONS.—To review the economic conditions in all branches of the fields assigned to them, and to produce a programme for the economic recovery of that field.

The committees are: (1) Food and Agriculture; (2) Fuel and Power; (3) Iron and Steel; (4) Inland Transport; (5) Maritime Transport; (6) Timber and (7) Manpower.

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